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TO ALL BANKS, CONTROLLING COMPANIES AND BRANCHES OF FOREIGN BANKS

**GUIDANCE NOTE 2/2008 ISSUED IN TERMS OF SECTION 6(5) OF THE BANKS ACT, 1990:
POSITION STATEMENT ON PERSONAL ACCOUNT TRADING**

EXECUTIVE SUMMARY

Banks Act Circular 6/2007 dated 14 November 2007 regarding consultation with banks, controlling companies and branches of foreign banks in respect of directives, circulars and guidance notes refers.

Personal account trading encompasses individual employees of a bank trading in financial instruments, the risks and rewards of which trading are for the employees' own personal benefit. Regulators around the world have definite concerns about allowing employees of banks to trade for their own account.

This Office is of the opinion that, in the final analysis, the only way in which the problem can be avoided is for banks in South Africa not to allow employees to conduct personal account trading. An opinion often held by banks, however, is that they would lose competent staff if personal account trading were to be forbidden entirely. There is no doubt, however, that, in cases when personal account trading by employees is allowed, certain minimum industry standards should be applied.

This Office, in consultation with the industry and the Financial Services Board, has prepared a set of guidelines in this regard. Banks are expected to establish their own set of controls and rules, based on these guidelines. Should these guidelines not be followed, this Office will have to consider issuing a set of regulations to govern personal account trading.

1. Introduction

The purpose of this guidance note is to set out the position of this Office on personal account trading (PA trading) by the employees of banks. This Office has conducted a survey amongst all banks trading in securities with the specific purpose of establishing the level of risk management in these trading banks.

One of the areas investigated was PA trading by the employees of these banks. PA trading encompasses individual employees of a bank trading in financial instruments, the risks and rewards of which trading are for the employees' own personal benefit. This applies similarly to non-bank financial institutions.

The information gathered from the survey indicates that, in general, PA trading poses a problem for trading banks. The survey found that different banks have implemented a variety of control measures. At the one end of the scale, some banks have no rules regarding PA trading, whereas, on the other end, some banks do not allow any PA trading at all. The majority of banks, however, have some rules governing PA trading, ranging from prior written approval to full transparency. In many cases, the management of banks are very reluctant to enforce strict rules, since they are of the opinion that they might lose competent staff, who would be difficult to replace. Some banks allow PA trading and treat it as part of the remuneration packages of employees.

Regulators around the world have definite concerns about allowing employees of banks to trade for their own account. The most important concerns relate to the following:

- Trading based on insider information.
- Deliberate delays of trades.
- Apparent conflicts of interest.
- Distraction of dealers.
- Division of loyalty.
- Opportunity to conceal fraud.

With regard to PA trading, the aim of this Office is to ensure the efficiency and stability of the financial system and of individual banks in order to safeguard investor-protection mechanisms to the maximum extent, through the implementation of sound corporate governance, internal controls and systems.

2. This Office's position on PA trading

This Office is of the opinion that, in the final analysis, the only way in which the problem can be avoided is for banks in South Africa not to allow employees to conduct PA trading. An opinion often held by banks, however, is that they would lose competent staff if PA trading were to be forbidden entirely. It is, therefore, recognised that banks could experience difficulty with retaining and employing sufficiently competent staff by not allowing employees to participate in this activity. This Office would therefore leave it to the discretion of a bank to decide whether to allow PA trading by employees. A total ban on PA trading could drive it underground, which would also not be desirable.

There is no doubt, however, that, in cases when PA trading by employees is allowed, certain minimum industry standards should be applied. When PA trading is allowed, it becomes the responsibility of the management of a bank to establish the necessary systems of control in order to avoid conflicts of interest, prejudice towards clients and prejudice towards the bank itself.

The role of this Office is therefore as follows:

- To encourage the establishment of minimum acceptable standards for the industry as a whole. This Office does not wish to institute regulations governing PA trading. This Office, in consultation with the industry and the Financial Services Board, therefore, prepared a set of guidelines (see paragraph 4 below). Banks are expected to establish their own set of controls and rules, based on these guidelines. Should these guidelines not be followed, however, this Office will have to consider issuing a set of regulations to govern PA trading.
- This Office, during the normal course of its duties, may also monitor compliance with the self-imposed PA trading rules by the industry as a whole.
- In the event of any transgression of these self-imposed rules, this Office may require a complete investigation and follow-up action to be instituted by an appropriate third party.

3. Underlying principles

This Office's position on PA trading is based on the following underlying principles:

- Any proposed minimum standards should help to promote the regulatory objectives of stability, efficiency and investor protection.
- Only independent, duly authorised, fit and proper people should manage and supervise employees who are active in PA trading.
- Stringent risk-management control principles should underlie all decisions of those managing and supervising the PA trading of employees.
- Contamination between risks arising from normal trading activities and those arising from PA-trading activities should be minimised.

4. Guidelines for self-imposed PA trading rules

In order to provide some indication of the minimum requirements that this Office will consider in assessing the adequacy of standards and controls instituted by banks with regard to PA trading, PA trading guidelines are furnished hereunder.

4.1 Compliance

A senior manager shall act as compliance officer and be responsible for the enforcement of the bank's PA trading rules. The compliance officer should report to the audit committee, the board of directors and this Office, and shall be responsible for the following:

- Approval of all PA trades, whether they are purchases or sales of financial instruments.
- Keeping of proper records of all such transactions.
- Informing the senior management of the bank concerned immediately of any transgressions of the rules.
- Power to close out trades entered into in contravention of the rules.

- Reporting of any material transgressions to this Office.

4.2 Prior written approval

Any employee of a bank shall be required to obtain written approval before entering into any PA transaction. The employee shall have to declare the following:

- The intent of the PA transaction, stating whether the transaction is for speculative purposes or for investment purposes.
- The type of security.
- The nature of the transaction (that is, purchase or sale, quantity, proposed date and time, etc.).
- Counterparty to the transaction for unlisted securities.
- The broking firm through which the transaction will be executed. (Off-market trades in listed securities should be prohibited.)

Any permission granted shall set out the period for which permission is given, or the date on which the permission will be reviewed.

With regards to dealing staff, it is strongly recommended that they be obliged to hold their PA positions for a minimum period of 30 days.

4.3 Conditions of employment

The rules governing PA trading should form part of the conditions of employment. A statement should be signed by the employer and the employee in order to ensure that the employee is fully aware of the particular bank's PA trading rules.

4.4 Conflict of interests

Employees shall exercise due care in determining whether any intended trade is in conflict with the interest of the bank or its clients, or with the rules. Traders should not be allowed to conduct PA trading in securities in the market sector in which they trade on behalf of their employer. Capital-market traders of a bank should therefore not be allowed to conduct PA trading in capital-market securities. In the event, however, of traders conducting PA trading in securities other than their market sector, the traders should trade such securities through the appropriate trading desk of their own bank or through an appointed, recognised and approved third party. Trading through the mentioned third party will be allowed provided that any such broker has agreed in writing to provide the bank, on request, with a copy of the contract note or equivalent. Employees may not request or accept any credit or special dealing facilities with external brokers.

4.5 New listings

The minimum standards must take into account new listings, and if special rules are required, such rules should be issued.

4.6 Underwriting

The employee may not act as an underwriter or sub-underwriter of securities if the bank is acting in that capacity, or if the employee knows that the bank will be offered a participation, underwriting or sub-underwriting in that security.

4.7 Application of rules

The rules shall be applied to all employees, including senior management, and provision shall be made for appropriate disciplinary action.

4.8 Future developments

In order to maintain the integrity of the system and to enable South African banks to stay abreast of developments in South Africa and internationally, it is imperative that there be a commitment to updating the standards whenever changes thereto are deemed appropriate. Since PA trading affects all financial markets, close co-operation between all regulators and the financial industry is of the utmost importance.

5. Definitions

In this guidance note the words hereunder shall bear the meaning so assigned thereto and, unless the context otherwise indicates-

Connected person means-

- i. a spouse or partner;
- ii. minor children;
- iii. any person in a business or profit-sharing relationship with the employee, including partners in an investment club;
- iv. a trust of which the employee or any person mentioned in (i) or (ii) is a beneficiary;
- v. a company in which the employee or any person mentioned in (i), (ii) or (iv) is a shareholder;
- vi. a pension fund (other than a pension fund managed by the bank) of which the employee or any person mentioned in (i), (ii) and (iii) is a beneficiary; or
- vii. any other accounts from which the person has a direct or indirect benefit.

Employee means-

- i. any person employed by the bank, including persons dealing on behalf of the bank or its clients; or
- ii. any person who is privy to confidential or proprietary information that could result in a conflict of interest if the employee, including a person on secondment or contract and a connected person, were to use the information to his/her advantage.

Rules means-

the personal account trading rules that are enforced by the bank from time to time and which comply with the minimum standards set out in this guidance note.

Securities includes-

"securities and financial instruments" as defined in the Financial Markets Control Act, 1989 (Act No. 55 of 1989), and the Stock Exchanges Control Act, 1985 (Act No. 1 of 1985), respectively, and any unlisted instruments such as bonds, futures, options, forward rate agreements, swaps, equities and derivatives of any of these, but excludes all unit trusts other than unit trusts listed on a recognised exchange or with assets under management by the bank.

6. Conclusion

The implementation of minimum industry standards with regard to PA trading needs the serious attention of the participants in the market. Previous initiatives to establish such standards should be augmented in order to raise industry standards and should involve all market participants. Such a co-ordinated industry initiative on minimum standards for PA trading would result in a market-based solution and should reduce the likelihood of regulations being imposed to control such activities.

7. Acknowledgement of receipt

Two additional copies of this guidance note are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.



E M Kruger
Registrar of Banks

The previous guidance note issued was Guidance Note 1/2008 dated 7 May 2008.