



South African Reserve Bank

**Remarks by Daniel Mminele,  
Deputy Governor of the South African Reserve Bank,  
at the  
ACI South Africa – The Financial Markets Association**

**Market conduct and market best practice**

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**Introduction**

Good evening, ladies and gentlemen.

Thank you to ACI South Africa for inviting me this evening, and for creating the opportunity for us to interact on the very pertinent subject of market conduct issues and best market practice.

In the over 60 years of its existence, ACI has made good progress in influencing industry behaviour and supporting market best practice, with member education and the promotion of the highest standards of ethical conduct being among the core principles guiding the work of the ACI worldwide. It is indeed always a pleasure to engage with you as our partners in the financial markets as we continue to strive towards promoting more effective and more efficient foreign exchange markets, our collective efforts aimed at increasing transparency, minimising risks, and enhancing confidence between ourselves as market participants and the people we serve.

About 15 months ago, the South African Reserve Bank (SARB) co-hosted, with the Group of Thirty (G30) and Barclays Africa, a forum on banking conduct and culture. At the time, we spoke extensively about the enormous trust deficit that had built up since the global financial

crisis as well as about efforts to restore confidence and trust not only in banks, but also in the effective and efficient functioning of financial markets. The G30 had just released a report, titled *Banking conduct and culture: a call for sustained and comprehensive reform*, which is still very relevant today, not least because the implementation of required conduct reforms has been somewhat slow.

The focus of that G30 Forum was mainly on banks because, as Sir David Walker of the G30 had put it, ‘the social externalities of banking are as great as, if not greater than, those of any other “business”’. Moreover, the majority of the conduct issues that we are grappling with has originated from the banking sector, be it issues around reference rates, as we saw with the Libor scandal in 2012, or the manipulation of foreign exchange rates and benchmark fixings, including, as you know, allegations of distorting competition being levelled at certain institutions trading in our own currency.

Focusing on banks, however, should not be construed to suggest that we should be less worried about the role played by other financial services providers and in the process inadvertently create scope for arbitrage opportunities. Today, we have broadened the scope of our activities to recognise this and to avoid an unintended consequence of creating an uneven playing field that could fuel financial disintermediation. I will talk more about broadening the scope of our initiatives later when I give a review of what we have already implemented and are still in the process of implementing here in South Africa.

Often, when misconduct has occurred, there tends to be the temptation to look to increased regulation as the best way to go about fixing the problem. As I said at the G30 Forum, it is preferable for market participants to self-correct on the basis of guidelines (not rules) that are developed to address integrity within banks as well as between banks and other stakeholders in the financial services industry – all in the interest of financial stability and the longevity of the role of banking in financial systems. Longer-lasting solutions are required to embed the correct culture rather than to impose conduct rules and police market participants. The financial services industry needs a fundamental shift in its mind-set on culture – that which is a value system that shapes the way in which we do business and contributes to building and maintaining trust. This is not to say that these value systems do not exist; I just think that the need to ‘meet targets’ in a profit-driven environment often

supersedes other goals and creates conflicts of interest. A regulatory response should be the last resort, only when there is clear evidence that self-regulation has failed.

All market participants should ensure that the performance assessment and compensation of employees takes adequate account of governance, compliance and market conduct – and not solely of profits generated. Individuals who do not meet a specified threshold of acceptable behaviour that is aligned to their employer's value system and conduct expectations should feel the direct effect on their discretionary compensation. To guide this, the Financial Stability Board (FSB) has developed a set of principles for sound compensation practices; the aim of these principles is to reduce incentives for excessive risk taking that may arise from the structure of compensation schemes in significant financial institutions. As a member of the FSB, South Africa subscribes fully to these principles.

Moreover, advancement in the financial services industry should increasingly recognise the behaviour and conduct of employees. This should be done in the spirit of encouraging the type of behaviour that is aligned to the desired culture and addressing lapses by holding those responsible accountable. The leadership should be seen to be leading by example. The desired culture and conduct should cascade from top to bottom. Boards of directors and chief executive officers should also change their behaviour from recognising just the results to also embracing the 'how' aspect that should talk more to the manner in which the results were achieved.

### **The financial markets review**

Let me return to my earlier remark about the initiatives of regulatory authorities in overseeing market conduct.

It is very important to emphasise that the initiatives which we have thus far embarked on are not about creating rules of conduct, but are meant to be guiding principles intended to create consensus on the standards of market practice. The Fixed Income, Currencies and Commodities Markets Standards Board (FMSB) in the United Kingdom (UK) is a good example of what this means. The FMSB is a private-sector body, which cooperates closely with the official sector, with a mission to create and enhance standards of behaviour by

developing principles of good conduct. Since its inception in 2015 the FMSB has already issued standards relating to 'Reference Price Transactions for the Fixed Income Markets', Binary Option for the Commodities Market, and New Issue Process Standard for the Fixed Income Markets'. South Africa is working on establishing a standards group similar to the FMSB as part of a broader financial markets review.

The former Minister of Finance announced in his Budget Speech in February 2017 that a financial markets review, modelled on the Fair and Effective Markets Review in the UK – which gave rise to the formation of the FMSB just mentioned – would be undertaken in 2017. This work has already started and market participants will be consulted as part of the process. The review will focus on conduct practices aimed at improving effectiveness to the benefit of market participants and customers. This review exercise will be a lot more comprehensive than the initial foreign exchange review that the SARB and the Financial Services conducted in 2014; it will consider conduct in the wholesale money, debt capital, foreign exchange, commodities and derivatives markets.

The Financial Markets Review Committee (FMRC) – which operates under the guidance of a joint steering committee comprising National Treasury, the Financial Services Board and the SARB – will look mainly into the following aspects in relation to market conduct:

- Review the standards and practices in South Africa's wholesale financial markets, both regulated and unregulated.
- Review governance, accountability and incentives in wholesale financial markets.
- Develop overarching principles for conduct and integrity to provide a consistent framework for specific reforms in wholesale financial markets.
- Identify any gaps in the legislation, regulation and/or supervision of conduct in wholesale financial markets, to be addressed through the market conduct policy framework under the Twin Peaks model of regulation.
- Identify and incorporate the role of global standards and good practice in South Africa's regulatory approach to wholesale financial markets.
- Develop recommendations for regulators on a pre-emptive, outcomes-focused and risk-based approach to conduct and integrity in wholesale financial markets.
- Facilitate the establishment of a market-led Financial Markets Standards Group.

The FMRC will develop an overarching definition and high-level principles of sound conduct and integrity for wholesale financial markets. The recommendations will focus on specific tools to strengthen the implementation and governance of conduct standards by market participants as well as on areas where changes to financial markets legislation and associated subordinate legislation are required to support a new conduct framework for wholesale financial markets. This area of work will evaluate the concept of market integrity in South Africa and will set out the expected outcomes that characterise market integrity. It will examine how, where appropriate, the market integrity objective can be given effect through legislation and market-led initiatives. The review will examine existing initiatives relating to wholesale market conduct and incorporate these work streams under the recommendations. The review will not duplicate work that has already been undertaken or is in progress but will rather draw on conclusions and recommendations, where available. To ensure that this is not a one-off exercise to tick a box that we, like other jurisdictions, have conducted a market review, a Financial Markets Standards Group will be established with the objective of sustaining the good practice standards for wholesale financial markets.

The mandate of the FMRC indicates that its focus is much broader than just the banking sector. This is one of the ways in which we are trying to prevent the unintended consequence of creating an uneven playing field. This approach is meant to recognise the evolution of asset managers and hedge funds, for example, from being niche businesses to playing a more important role in the financial system.

The financial markets review, which we hope will be completed by the end of 2018, is just one of many initiatives that South Africa has embarked on. Allow me to now touch briefly on the other initiatives that are also aimed at strengthening market conduct.

### **The Twin Peaks model of financial regulation**

Very relevant to our discussions here today is the introduction of the Twin Peaks model of financial regulation in South Africa that proposes a new approach to the regulation of market conduct, namely through the establishment of a standalone conduct authority for the financial services industry. This proposal was first put forward by National Treasury in 2011

and I am sure everyone here is aware of what the plan is going forward. Nonetheless, let me remind you that, among other things, the proposed conduct authority will have a mandate to enhance and support the integrity and efficiency of the domestic financial system. This mandate will be provided for in the Financial Sector Regulation Bill which is expected to confer powers on the SARB (as the Prudential Authority) and the Financial Services Board (as the Financial Sector Conduct Regulator) to preserve and enhance financial stability and to improve market conduct in order to protect financial customers.

## **Codes of conduct**

In the wake of the recent scandals of market manipulation, South Africa has been very active in the development of codes of conduct, starting with the Jibar<sup>1</sup> Code of Conduct in 2012, the Code of Conduct for authorised Over-the-counter (OTC) Derivative Providers is in the process of being finalised and, most recently, the Code of Conduct for wholesale OTC financial markets (OTC Code) which is still in a developmental phase, having had the benefit of input from relevant financial market stakeholders. It is envisaged that a number of other specialist codes of conduct will be developed for different segments of the wholesale financial markets, with the OTC Code serving as a general code for those market participants who are not covered by a specific code of conduct pertaining to their market segment.

As regards the foreign exchange market, many of you will be aware that the BIS Foreign Exchange Working Group released the Global Foreign Exchange Code (the Global Code) last week, which addresses, in a comprehensive manner, best practice covering areas such as market ethics and information sharing, but also tackles complex issues such as electronic trading and algorithmic trading. This is the first time that a single, unified, global code was established, providing guidance and principles that can apply across many jurisdictions and market segments. The SARB was afforded the opportunity to participate in the development of the Global Code. South Africa has become a member of an expanded and formalised Global Foreign Exchange Committee, whose objectives are to promote collaboration among local foreign exchange committees, to exchange views on trends and developments in

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<sup>1</sup> Johannesburg Interbank Agreed Rate

global foreign exchange markets, and to promote, maintain and update the Global Code on a regular basis to ensure its continued relevance. Each member foreign exchange committee designates a central bank and private sector representative for the Global Foreign Exchange Committee.

Following consultations with the Financial Markets Liaison Group and its foreign exchange subcommittee, we have endorsed and adopted the Global Code. This endorsement of the Global Foreign Exchange Code implies that we are now committed to evolving our own institutions' foreign exchange practices to be consistent with the principles outlined in the Code. This will include a review of the structure of our local foreign exchange committee over the next few months. We believe that this code is a big step in the right direction and will contribute to strengthening standards in foreign exchange markets around the globe.

The Global Code contains principles of good practice that provide a common set of guidelines to the market, with the intention of promoting the integrity and effective functioning of the relevant financial markets without imposing legal or regulatory obligations on market participants; the Code is not a substitute for regulation. Having endorsed the Global Code, the SARB will strive to adhere to it in its own market operations and, over time, we would also expect counterparties that we transact with in the foreign exchange market to confirm their commitment and adherence to the Global Code for them to continue to be eligible counterparties.

## **Conclusion**

I would like to conclude by saying that we are still some distance away from the finish line when it comes to inculcating the highest standards of conduct and market best practice. And it is not the job of the regulators alone to cross that line; it is the job of the financial sector as a whole. We recognise the contributions that each of you makes towards strengthening the standards of market practice. In continuing to do so, I would like to appeal to you to take very seriously the challenge of aligning your current culture to the desired culture. There is definitely the need for a fundamental shift in the mind-set of the financial services industry on the issue of culture; more regulation is not necessarily the best way to go about fixing problematic conduct.

I am pleased to note that, following the launch of the Global Code last week, ACI Worldwide has announced that it has developed a new ACI Global Foreign Exchange Code Certificate aligned to the principles and practices of the new code. This initiative is certainly a step in the right direction to promote the integrity and effectiveness of the foreign exchange market.

Let me use this opportunity to ask for your cooperation with our current review of the standards and practices in the domestic wholesale financial markets. The committee that has been appointed to carry out this review will soon be on your doorsteps, seeking to engage with you on various aspects relating to the structure of the financial markets.

Together we can make it work.

Thank you very much.