THE FINANCIAL SERVICES TRIBUNAL

CASE NO: A23/2019

In the matter between:

MET COLLECTIVE INVESTMENTS (RF) (PTY) LTD Applicant

and

FINANCIAL SECTOR CONDUCT AUTHORITY Respondent

APPLICATION FOR RECONSIDERATION OF A DECISION AND ORDER OF THE COMMISSIONER, FSCA, IMPOSING AN ADMINISTRATIVE PENALTY

Tribunal: LTC Harms (chair), Adv H Kooverjie SC and Adv W Ndinisa

For the applicant: Adv B Berridge SC instructed by Webber Wentzel Attorneys (Mr T Versveld)

For the respondent: Adv AJ Freund SC and Adv N Mayosi

DECISION

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1. The Commissioner of the Financial Sector Conduct Authority, Mr A M Sithole, in his capacity as the responsible authority for financial sector laws, imposed on 12 September 2019 an administrative penalty of R100 million on the applicant, MET Collective Investments (RF) (Pty) Ltd (hereinafter "MetCI"), because, he found, MetCI had contravened different provisions of financial sector laws. MetCI applied for a reconsideration of the decision on a number of grounds, which will be dealt with later.

2. The "financial sector laws" concerned are the Collective Investment Schemes Control Act 45 of 2002 ("the Control Act"), two notices issued thereunder, namely Board Notice 90 of 2014[1] and Board Notice 92 of 2014,[2] as well as the Financial Institutions (Protection of Funds) Act 28 of 2001 ("the Protection Act").

3. The authority to impose administrative penalties is to be found in sec 167 of the Financial Sector Regulation Act 9 of 2017 ("the FSR Act") and the jurisdiction of this Tribunal to reconsider the decision of the Commissioner in sec 230 of the FSR Act read with sec 1A(9) of the Control Act.

A THE CONTROL ACT

4. MetCI was during the relevant period (2014 to 2016) the "manager" of a collective investment scheme in securities, the "Third Circle MET Target Return Fund". This means that MetCI was authorised to administer the scheme .

5. A manager must administer a collective investment scheme honestly and fairly, with skill, care and diligence, and in the interest of investors and the collective investment scheme industry (sec 2(1)).

6. The duties of a manager of a scheme are to maintain adequate financial resources to meet its commitments, and to manage the risks to which such a scheme is exposed (sec 4(3)). A manager must, in particular:

[1] BN90: "Determination of securities, classes of securities, assets or classes of assets that may be included in a portfolio of a collective investment scheme in securities and the manner in which and the limits and conditions subject to which securities or assets may be so included", *Government Gazette* 37895 of 8 August 2014.

[2] BN 92: "Advertising, marketing and information disclosure requirements for collective investment schemes", *Government Gazette* 37895 of 8 August 2014.

(a) organise and control the collective investment scheme in a responsible manner;

(b) keep proper records;

(c) employ adequately trained staff and ensure that they are properly supervised; and

(d) have well-defined compliance procedures. (Sec 4(4).)

7. As manager MetCI was entitled, with the necessary approval, to delegate any function listed in the definition of "administration"[3] to a "delegated person" (sec 4(5)(a)). Delegation however does not mean substitution because:

> "***anything done or omitted to be done by the delegated person in the performance of a function so delegated, must be regarded as having been done or omitted by the manager***" (sec 4(5)(b)).

8. MetCI concluded such an agreement,[4] named a "co-naming" agreement, with Third Circle Asset Management (Pty) Ltd ("Third Circle") to act as investment manager, thereby converting a number of portfolios from white labels to co-named portfolios. This explains the name of the scheme, namely "Third Circle MET".

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[3] Sec 1: "administration" means any function performed in connection with a collective investment scheme including

(a) the management or control of a collective investment scheme;
(b) the receipt, payment or investment of money or other assets, including income accruals, in respect of a collective investment scheme;
(c) the sale, repurchase, issue or cancellation of a participatory interest in a collective investment scheme and the giving of advice or disclosure of information on any of those matters to investors or potential investors; and
(d) the buying and selling of assets or the handing over thereof to a trustee or custodian for safe custody

[4] B 90.

9. The fact that the delegation did not affect the duties and obligations of MetCI as "manager" was recorded in the agreement: the parties acknowledged that MetCI, as manager, "***was governed by and obliged to comply with the Control Act, the Deed and every Supplemental Deed in every respect***".[5]

10. The investment manager, in turn, undertook to comply with the Control Act and all the obligations reflected in the trust deeds.

11. Standard Bank Ltd was appointed in terms of sec 68 as trustee.[6] The trustee was obliged to ensure that the investment policy was carried out (sec 70)).

12. The supplemental trust deed set out the investment policy of the Fund.[7] It recorded that the primary objective of the fund was to offer stable positive returns, mainly in the form of capital growth, and was to focus on active equity risk management and maximising the capital return earned from the part of portfolio at the discretion of the manager. The portfolio aimed to deliver this in all market circumstances (rising and falling markets) by investing in positions and hedges that allow for equity upside while protecting the investor on the downside. In order to achieve its object, the investment normally to be included in the portfolio could comprise a combination of assets in liquid form. The portfolio could from time to time invest in financial instruments in accordance with the Control Act and Regulations to achieve the portfolio's investment objective.

13. The Fund served as a building block for the Third Circle Met Defensive Fund of Funds where most retail clients were invested. The exposure of an investor in the Fund of

[5] B 94, para 3.1.
[6] B 424.
[7] B 426.

Funds was accordingly diluted to the percentage exposure or weighting the Fund represented the total assets of the Fund of Fund.

B THE BLACK SWAN EVENT

14. MetCI informed the Registrar of Collective Investment Schemes on 1 March 2016,[8] that the Fund had lost 66% of its value during what it called the volatile market conditions during December 2015. It said that the strategy employed by the portfolio manager (Third Circle) was unable to cope with the extreme market events and as a result the Fund suffered losses due to the extreme market movements. It added that the use of derivative instruments (futures, put and call options) and hedging techniques employed by the "manager" (presumably Third Circle) were unable to deploy and behave as the "investment manager" had expected, therefore resulting in the significant deviations.

15. The loss in asset value took place during the period 7 to 10 December 2015. A significant event causing volatility took place on 9 December after the markets had closed. The Minister of Finance, Mr Nene, was unexpectedly replaced by the President. Although MetCI initially relied heavily on this event as the explanation for the loss in value of the portfolio, counsel during oral argument – in contradistinction to para 11 of the heads of argument – adopted the line set out in the reconsideration application (para 16), namely that the event "contributed" to the diminution in value.

16. The facts, which counsel for MetCI studiously evaded in his heads and during argument, are stark. On 7 December, the total market value of the portfolio was R345.8 million whereas its net effective exposure was already R1 306.5 million. The

[8] B 460.

investment loss between close of business on 9 and 11 December was calculated to be 68.3%. By 14 December, the Fund reduced its loss of market value to 43.7%.

17. The MDDs (Minimum Disclosure Documents), for which MetCI was responsible, gave the picture in Rand and cents. The portfolio size on 30 November 2015 was R387.28 million,[9] and on 31 December 2015 amounted to R157.72 million,[10] a difference of some R130 million. A PowerPoint presentation[11] by MetCI of 17 September 2016, dealing with cumulative returns, shows a 66% drop during December 2015, and no real recovery even in July 2016, the last date.

18. The question is why did the Fund lose more than 50% of its value over the fateful few days during December 2015? Counsel for MetCI faintly suggested that it was because of "shortcomings" in the manner in which Third Circle managed the Fund, and secondly the [lack of or insufficient] oversight and control functions exercise by MetCI over Third Circle.[12]

19. We accept, as submitted by respondent's counsel, that the reason was that the Fund was virtually exclusively invested in derivative instruments, and that the extent of the loss was a result of the nature of the derivatives, the extent of the resultant effective exposure, the lack of cover, and the fact that the Fund had gone into an overdraft position (minus R31.3 million as at 7 December, fluctuating to minus R307.4 million on 11 December).

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[9] B 446.

[10] B 456.

[11] B393

[12] Applicant's heads para 11

C THE APPLICATION FOR RECONSIDERATION

20. The executive summary of the lengthy application for consideration speaks in general terms about the setting aside of "several of the findings made by the Commissioner". It summarised a number of procedural issues and dealt with the quantum of the penalty. It concluded by stating that "the above constitutes only a brief summary of the main grounds" and referred generally to its earlier responses running to some 400 pages. The application, then, in para 76, launched a broad attack on the Commissioner's finding in relation to breaches relating to BN90 (to which we revert).

21. MetCI's heads of argument submitted that the decision had to be set aside because of (a) the flawed process, (b) the true nature and extent of the transgressions, and (c) the misapplication of sec 167 of the FSR Act. Although heads of argument are supposed to concentrate the mind, as Dr Samuel Johnson said in another context, no submissions were made in respect of the contraventions. In spite of Mr Freund's heads, which highlighted this, Mr Berridge did not, until driven, deal with "the nature and extent of the transgressions". Since those are material in considering the administrative penalty, we shall deal in some detail with the issue.

D THE "FLAWED" PROCESS

22. It was and remains unclear what MetCI wished to make of the alleged administrative flaws in the process, and Mr Berridge did not enlighten us. He submitted in his heads that this Tribunal has a wide discretion and acts "in effect, as a 'tribunal' in terms of and for the purposes of PAJA [Promotion of Administrative Justice Act 3 of 2000]" and that the "failures are, in and of themselves, fatal". Although he retreated somewhat from this standpoint during the oral argument, he (following the

reconsideration application) relied on a litany of PAJA complaints in attacking the Commissioner's decision.

23. Although we have before stated our position clearly, it appears that we have to do it again. Our position is, as it was with the then Appeal Board of the Financial Services Board, when the judgment in *Nichol and Another v Registrar of Pension Funds and Others* [2006] 1 All SA 589 (SCA), 2008 (1) SA 383 (SCA) was delivered. The Court pointed out that the Appeal Board was a specialist and independent tribunal as contemplated in sec 34 of the Constitution:

> "***It has very wide powers on appeal, including the power to confirm, set aside or vary the decision of the Registrar against which the appeal is brought; to refer the matter back for consideration or reconsideration by the Registrar in accordance with such directions as the Board may lay down; or to order that its own decisions be given effect to. In addition, it is empowered under section 26(2A) to grant interim relief by suspending the operation or execution of the decision appealed against and, under section 26(14), it can make an appropriate order as to costs. The Appeal Board therefore conducts an appeal in the fullest sense – it is not restricted at all by the Registrar's decision and has the power to conduct a complete rehearing, reconsideration and fresh determination of the entire matter that was before the Registrar, with or without new evidence or information***."

In short, this Tribunal is not much different, and it exercises an appeal jurisdiction of the first category referred to in *Tikly v Johannes NO* 1963 (2) SA 588 (T) 590.

24. As to reviews, in *JSE Limited v The Registrar of Security Services* the Appeal Board said follows:

"***This brings us to review grounds. The Appeal Board is not a review 'court' as defined in the Promotion of Administrative Justice Act 3 of 2000 ('PAJA'). Reviews are concerned with process; appeals with result. But that does not necessarily mean that review grounds may not overlap with appeal grounds. This is especially the position where a flawed process impacts on the result, for example, where the Registrar omitted to have regard to a jurisdictional fact***."

We have since said the same about this Tribunal.

25. MetCI's list does not differ much from that relied on in *Staufen Investments (Pty) Ltd v The Minister of Public Works, Eskom Holdings SOC Ltd & Registrar of Deeds, Cape Town* [2020] 2 All SA 738 (SCA); 2020 (4) SA 78 (SCA) at para 49, namely that (a) the Commissioner made use of an internal procedure which deprived MetCI of a full hearing; (b) MetCI was not afforded a right of reply to the inspectors' final submissions; (c) MetCI was not given full discovery of all documents and (d) the Commissioner did not apply his mind independently to the application but simply followed the recommendation in the internal memorandum which was prepared by officials.

26. The SCA dismissed those grounds and we, for the same reasons reject them. There is no reason to rehash or restate what therein stated.

27. One ground not already mentioned relates to delay: first, the delay between December 2015 when the loss was suffered and the decision on 1 October 2019; and second, the delay between the signature of the determination on 11 September 2019 and its release (with a degree of fanfare) on 1 October. Counsel did not inform us what this had to do with the merits of the matter. Another ground relied on is ulterior

motive and unwarranted dictates of another, to which we shall revert in another context.

E ADMITTED CONTRAVENTIONS OF BN90

28. Contrary to the lengthy submissions in the application for reconsideration, Mr Berridge accepted without argument that the Commissioner had held correctly that MetCI contravened para 15(1) of BN90:

> "***The sum of the effective exposures of listed financial instruments to be maintained in terms of this Chapter, together with the market value of all the physical underlying assets in the portfolio, may not exceed 100 percent of the market value of the portfolio***."

29. The enforcement report's uncontradicted conclusion [somewhat redacted] was the following:[13]

(a) The bulk of the portfolio value was represented by the cash held in the margin accounts at the JSE.

(b) The only physical assets held by the portfolio were unit trust holdings of R1.2m, invested mostly in money market instruments related to African Bank (at the time suspended). The Fund held no further "underlying assets".

(c) Applying the SAFEX/YIELDX deltas furnished by the JSE, the net effective exposure of the overall portfolio (i.e. the sum of the effective exposures of the financial instruments held by the Fund on each of 7, 8, 9 and 10 December,

[13] B 1300-1302.

together with the R1.2 million units, considerably exceeded the total market value of the portfolio.

(d) This was the case not only after the events of the evening of 9 December 2015 but also on each of the preceding three days. It is therefore apparent that the events referred to did not cause the breach.

(e) The fund should also have had money in its current account, but it went in and out of overdraft. The current account was in overdraft two days before the events of 9 December 2015 and was therefore also not attributable to market movements post the event.

(f) The extent of the breaches using the JSE deltas and expressed as a percentage were 377.80%, 417.70%, 383.40% and 281.70% on the respective days. The effective exposure calculations provided by the Trustees for 8 December 2015 show effective exposure was R1, 524.0M (478% of the market value of R318, 9m), compared to R1, 330.7m calculated by the JSE (417% of the market value).

(g) Information furnished to the inspectors by MetCI shows that MetCI's own systems had shown the Fund to be in breach of para 15(1) for the whole of the period from 17 November 2015 to 22 December 2015 (a period of 36 days), with an average breach of 669.92 percent.[14]

30. The Commissioner's conclusion that the breaches were by a "considerable margin" was somewhat of an understatement.

31. Mr Berridge further accepted that para 3(8)(c) of BN90 had been contravened. The regulation provides as follows:

[14] This percentage appears to be overstated.

"***The manager must ensure that the listed or unlisted financial instruments are not used to leverage or gear the portfolio and are covered at all times***."

32. The Commissioner did not err when he accepted, either word for word or in his own words, the findings in the enforcement report that the Fund was (on the JSE's deltas) 3.8 times geared on 7 December; 4.2 times geared on 8 December; 3.8 times geared on 9 December, and 2.8 times geared on 10 December, and that, accordingly, the Fund used financial instruments to gear or leverage the portfolio.

33. To contextualise this, the inspectors quoted from the Saayman report that stated that:

"***…The initial margin is normally only a fraction of the exposure taken as it is intended to cover only the change in value over a 2-day period at a 99.7% confidence interval. . . . This means that one can leverage one's investment by investing in futures, being exposed to market moves on a greater value of assets than one actually owns. The initial margin required by the JSE for this account in its entirety across equities, commodities, interest rate and currency derivatives was R319,650,158 on 8 December 2018. In comparison to that amount of initial margin, the net exposure in nominal terms was R1 330 681 925. That is, the fund was exposed to price movements on that net amount of assets. . . . That means that if the fund had no other assets other than the initial margin, the gearing was 4.2 times on a net basis. . . . Gearing is measured simply by dividing the exposure by the amount of the assets***."

34. Para 3(8)(c) also provides that the manager "must ensure" that the financial instruments "are covered at all times". This must be read with para 16. As the inspectors said, the fact that para 15(1) was breached necessarily implies that the

detailed cover requirements of para 16(1) were also breached.[15] The detail of the breaches appears from two tables. The first illustrates the aggregate net effective exposure calculations and cover requirements for assets in liquid form as of 8 December 2015.

Underlying asset	Financial instrument type	Relevant section of S16(1)	Aggregate net effective exposure
ALSI	Multiple, index, pos exp	(g), thus (c)	R1 071 498 751
ZAEU-F	Currency future	(i)	R406 580 000
ZAUS-F	Currency future	(i)	R366 782 500
MTNS	Multiple, equity, pos exp	(f), thus (c)	R118 074 559
ZAGB-F	Currency future	0)	R98 905 050
YLBQ	Sold put option	(c)	R53 948 245
SHPS	Multiple, equity, pos exp	(f), thus (c)	R52 327 993
YLCQ	Multiple, equity, pos exp	(f), thus (c)	R51672275
NEDS	Multiple, equity, pos exp	(f), thus (c)	R44 171 584
REMS	Multiple, equity, pos exp	(f}, thus (c)	R40 954 282
FSRS	Multiple, equity, pos exp	(f), thus (c)	R31 891 069
R186	Multiple, individual bond, pos exp	(f), thus (c)	R25 903 246
BGAS	Multiple, equity, pos exp	(f), thus (c)	R25 337 373
AGLS	Multiple, equity, pos exp	(f), thus (c)	R21030282
YKZQ	Sold put option	(c)	R20 606 047
WHLS	Multiple, equitv, pos exp	(f), thus (c)	R17 286 292
YKUQ	Multiple, equity, pos exp	(f), thus (c)	R14 355 806
LHCS	Multiple, equity, pos exp	(f), thus (c)	R12 588 636
SLMS	Multiple, equity, pos exp	(f), thus (c)	R9 263 007
BVTS	Multiple, equity, pos exp	(f), thus (c)	R7 721 989
IPLS	Multiple, equity, pos exp	(f), thus (c)	R 3 937 840

[15] B 1305-1308.

YLEQ	Sold put option	(c)	R 1253738
APNS	Sold put option	(c)	R 664 316
YKYQ	Sold put option	(c)	R 428 171
YGYQ	Sold put option	(c)	R 72 310
PLAT	Multiple, commodity, pos exp	(f), thus (c}	R 65 365
YKVQ	Sold out option	(c)	R 43 441

35. The other table set out the aggregate net effective exposure calculations and cover requirements for underlying assets at the same date.

Underlying asset	Financial instrument type	Relevant section of S16(1)	Aggregate net effective exposure
ZAEU	Multiple options, currency, neg exp	(h), thus (a)	(R 622 678 371)
ZAUS	Multiple options, currency, neg exo	(h), thus (a)	(R 436 826 330)
ZAGB	Multiple options, currency, neg exp	(h), thus (a)	(R 94 862 031)
GOLD	Multiple, commodity, neg exp	(h), thus (a)	(R 12 315 510)

36. The Commissioner was, accordingly, entitled to find that MetCI had breached its obligation to ensure that the financial instruments were covered at all times and that there were not nearly enough assets in liquid form to cover all the positions (positive net return), and Mr Berridge did not argue otherwise.

F ADMITTED ADMINISTRATIVE / CONTROL / ORGANISATIONAL CONTRAVENTIONS

37. The duties of a manager under sec 2(1) and 4(4) of the Control Act were set out earlier. MetCI admits, through Mr Berridge, that:

(a) it failed to exercise the required skill, care and diligence, and failed to control the scheme in a responsible manner because, over an extended period, it did not have the appropriate risk insight and risk management;

(b) it permitted on-going investment in derivatives for which effective exposure could not be determined;

(c) it did not have over an extended period an efficient daily risk management program (para 3(2)(c) of BN90);

(d) it did not have a well-defined compliance procedure (sec 4(4)(d) of the Control Act);

(e) it did not have standards that ensured proper management of risk (para 7(1));

(f) it did not have appropriate risk management systems (para 7(3));

(g) there was a lack of data integrity (para 7(7)); and

(h) there was a lack of periodic evaluation of appropriate risk management processes (para 8(1), all of BN90).[16]

38. There is obviously a large measure of overlap between the different contraventions and all come basically back to a failure to administer the scheme with skill, care and diligence, and in the interest of investors and the collective investment scheme industry.

G THE MINIMUM DISCLOSURE DOCUMENTS (MDDs)

39. MetCI, as it was obliged to do, issued MDDs periodically. These were presumably sent to investors and were in addition placed on its webpage. MDDs are regulated by BN 92 of 2014. A manager must ensure that each MDD:

[16] A136.

"***sets out the essential characteristics of a portfolio or portfolio class which will enable an investor to understand the nature and the risks of the portfolio and to make informed investment decisions***" (para 16(3)(a);

and discloses at least

"***the risk reward profile of the investment, including appropriate guidance on and warnings of the risks associated with investment in the relevant portfolio***" (para 16(3)(e)(iii)).

40. Section 106(a) of the Control Act (additionally) provides that:

"***no person may make a statement or disseminate information which he or she . . . ought reasonably to know, is false or misleading***"

– ignoring for present purposes the alternative of "***or is likely or intended to induce other persons to purchase or deal in a participatory interest***".

41. The Commissioner found that MetCI contravened these provisions, at least in respect of the MDD of 30 November 2015. Mr Berridge said that MetCI does not agree but he did not say why and left it to us to find the reasons in the 450 pages of submissions MetCI had made.

42. The MDD of 30 November 2015,[17] under the heading "Portfolio profile", stated that the primary objective of the Fund was to offer stable positive returns mainly in the form of capital growth, and focussed on active equity risk management and maximising the capital return earned from the portfolio at the discretion of the manager. Under the heading "Disclosures" is a generalized statement that:

[17] B446.

"***This portfolio is permitted to invest in foreign securities which, within portfolios, may have additional material risks depending on the specific risks affecting that country, such as potential constraints on liquidity and reparation of funds; macroeconomic risks; political risks; foreign exchange risks; tasks risks; settlement risks; and potential limitations on the availability of market information. Fluctuations or movements in exchange rates might cause the value of underlying international investments to go up or down. Investors are reminded that investment in a currency other than their own may expose them to a foreign exchange risk***."

43. As to particulars, under the heading "Portfolio Holdings" it is said that the "SA Cash/Money Market" or "cash", which was interest bearing, amounted to 96.14% of the portfolio, while the equity allocation of derivatives was 2.21%. Since we know that the portfolio consisted almost exclusively of derivatives and was in overdraft, the information given was demonstrably false. Reading the MDD "holistically" or as a "sophisticated and experienced institutional investor" would not change that; neither does the fact that other funds may have published similar untrue information.

H THE TRUST DEED

44. The Protection Act states that anyone who:

"***administers trust property under any instrument or agreement why not cause such trust property to be invested otherwise then in a manner directed in who required by such instrument or agreement***" (sec 4(1)).

A person who contravenes or fails to comply with this provision is guilty of an offence (sec 10).

45. This should be read with para 3(8)(b) of BN90. Listed and unlisted financial instruments:

> "***may only be included for the purposes of efficient portfolio management with the aim of reducing risk, reducing cost for generating capital or income for the portfolio with an acceptable level of risk or to achieve the investment objective of the portfolio . In this instance, the manager must ensure set a portfolio's investment policy provides for the inclusion of listed and unlisted financial instruments***."

46. The primary object of the Fund, as set out in the supplementary trust deed, has been set out earlier and the eventual question is whether the risk incurred in this instance was an acceptable risk since any substantial downside move would have been catastrophic as explained by Saayman.[18]

47. The Commissioner[19] dealt with this aspect at some length and noted that although MetCI took issue with many of the inspectors' argument, it was equivocal as to whether it ultimately admitted or denied the core allegation of non-compliance. The equivocation is absent in the reconsideration application – the issue is not referred to at all. Mr Berridge did not deal with it and when pressed simply said that MetCI does not accept the finding.

48. Having reconsidered the issue, we can find no fault with the Commissioner's finding, quoted by Mr Freund, that:

[18] Enforcement report B1313.

[19] A 111-114.

"***it was reasonably foreseeable that, if the market were to move against it, the portfolio would have to fund the variation margin (mark-to-market losses); and reasonably foreseeable that, given that virtually all of its funds had been placed as initial margin, it would have no capital to absorb temporary losses and would have to liquidate some of its portfolio's derivative assets to release initial margin to pay variation margin. This would lock in losses and remove its ability to profit fully in a reverse move of the market***."[20]

49. To this may be added the Commissioner's ultimate finding on the subject. Mr Ian Lane, who acted on behalf of Third Circle as portfolio manager, explained the fund strategy and investment philosophy of the Fund in a letter of 12 August 2016:[21]

"***The strategy aims to generate returns by exploiting certain structural properties of the derivatives markets in conjunction with the statistical properties of the underlying assets. Expressing these views by way of investing principally in near- term expiry derivative structures yields a highly desirable asymmetric return profile that is uncorrelated to major asset class benchmarks. This thus represents a unique and uncorrelated potential driver of returns in the collective investment scheme space, which we believe to have valuable potential utility in improving the diversification and advancing the efficient frontier of a portfolio of collective investment schemes***."

50. This is a far cry from a portfolio whose objective was to offer stable positive returns, mainly in the form of capital growth, and was to focus on active equity risk management and maximising the capital return at the discretion of the manager who would "from time to time" invest in financial instruments in accordance with the

[20] Respondent's heads at para 10.23

[21] B 432.

Control Act and regulations "to achieve the portfolio's investment objective".[22]

51. We therefore conclude that the jurisdictional fact for the imposition of an administrative penalty in terms of sec 167 of the FSR Act was established: MetCI contravened the mentioned financial sector laws as found by the Commissioner.

I THE TRANSITION

52. There is this complication. The transgressions occurred during December 2015, while the FSR Act came into force on 1 April 2017. Until then, administrative penalties were dealt with under the Protection Act, secs 6A to 6H. These sections have been repealed by the FSR Act, and although the FSR Act contains extensive transitional provisions it does not have transitional provisions in respect of administrative penalties.

53. Whether and to what extent a provision such as sec 167 is retrospective or retroactive[23] we need not decide because the Commissioner's decision, which was made on 11 September 2019 and published on 1 October 2019, dealt with the matter under sec 167 in accordance with the submissions that were made by MetCI to him, and that is how the case was argued by both parties. It is nevertheless necessary to deal with the old provisions because the investigation by the inspectorate before the introduction of the new regime took place under the old provisions and they give perspective to what was done and why. In addition, it is necessary to give context to penalties that were imposed under that regime.

[22] B 426.

[23] 25(1) *LAWSA* "Statutory law and interpretation" para 341.

54. The old sections provided for the imposition of an administrative penalty by an enforcement committee with an appeal to the High Court as if the determination were a decision of a magistrate in a civil matter. The present system is that the responsible authority for the financial law contravened, in this case the Commissioner, may impose the penalty. There is an internal remedy, namely the right of reconsideration by this Tribunal.

55. The erstwhile enforcement committee could impose any one or more of the following administrative sanctions:

(a) a penalty by ordering the respondent to pay a sum of money to the board; and
(b) order the respondent to pay to any person who suffered patrimonial loss or damage as a result of the contravention a compensatory amount determined by the committee to make good the patrimonial loss or damage so suffered.

(An alternative to (b) is not relevant.) Importantly, the administrative penalty under (a) had limited application: it was exclusively to be utilised for purposes of consumer education or the protection of the public.

56. The FSR Act is different. It no longer provides for compensation payable to those who have suffered patrimonial loss or damage as a result of the wrongdoing, and the administrative penalty recovered must be applied:

(a) first, to reimburse the responsible authority for its costs and expenses reasonably and properly incurred in connection with the relevant contravention, making the order and enforcing it; and
(b) then, the balance must be paid into the National Revenue Fund.

57. As to the factors determining the “appropriate” sanction, sec 6D(3) read as follows:

> “When determining an appropriate administrative sanction, the enforcement committee may have regard to the following factors:
>
> (a) The nature, duration, seriousness and extent of the contravention;
> (b) any loss or damage suffered by any person as a result of the contravention;
> (c) the extent of the profit derived or loss avoided by the respondent from the contravention;
> (d) the impact which the respondent’s conduct may have on the relevant sector of the financial services industry;
> (e) whether the respondent has previously failed to comply with a fiduciary duty or law;
> (f) any previous fine imposed or compensation paid for the contravention based on the same set of facts;
> (g) the deterrent effect of the administrative sanction;
> (h) the degree to which the respondent co-operated with MetCI and the enforcement committee; and
> (i) any other factor, including mitigating factors submitted by the respondent, that the enforcement committee considers to be relevant.”

58. Section 167(2) is different:

> “In determining an appropriate administrative penalty for particular conduct—
>
> (a) the matters that the responsible authority must have regard to include the following—

(i) The need to deter such conduct;

(ii) the degree to which the person has cooperated with a financial sector regulator in relation to the contravention; and

(iii) any submissions by, or on behalf of, the person that is relevant to the matter, including mitigating factors referred to in those submissions; and

(b) without limiting paragraph (a), the matters that the responsible authority may have regard to include the following—

(i) The nature, duration, seriousness and extent of the contravention;

(ii) any loss or damage suffered by any person as a result of the conduct;

(iii) the extent of any financial or commercial benefit to the person, or a juristic person related to the person, arising from the conduct;

(iv) whether the person has previously contravened a financial sector law;

(v) the effect of the conduct on the financial system and financial stability;

(vi) the effect of the proposed penalty on financial stability;

(vii) the extent to which the conduct was deliberate or reckless."

59. The differences between the two provisions are manifest. The purpose of a sanction under sec 167 is to act as a deterrent of "such conduct". That was not the purpose of the old section. The emphasis, if one reads it "holistically", was to compensate, and deterrence was but a factor which could have been taken into account.

60. We interpose to deal with the allegation of ulterior purpose. Mr Jurgen Boyd, MetCI's bugbear, is described in the heads as having played the role of the *eminence grise* in the matter. He disliked co-naming agreements and this, according to MetCI, gave rise to the recommendation that the full loss of the investors should be compensated without an administrative fine, and a refusal at a later stage, to negotiate. As shown, his stance that compensation should be paid was valid under the old provisions and

could have remained valid depending on how one considers the issue of retrospectivity.

61. The submission by Mr Berridge that his stance was "reflected in the FSCA's reports – the last of which became the Commissioner's Decision", is unjustified. The final report and the decision both recognise that compensation is no longer a permitted sanction, and the final report proposed (instead of the original compensation sanction of R175 million)[24] a sanction of between R50 million and R100 million, with a preference to the higher. The Commissioner decided as follows:

> "***I am persuaded by [MetCI] that there is no reason why the administrative penalty should be the same as the loss suffered by any person and, in any event, that the penalty of R175m suggested by the inspectors is too high, in all the circumstances***."[25]

62. The evidence before us is that Mr Boyd, because of the complaints of MetCI, had no role in the final decision and that it was the decision of the Commissioner himself, adopting much of the conclusions of the inspectors.

J <u>DETERRENCE</u>

63. Deterrence is an elastic concept with grey borders, and it is easy to justify a sanction which is in effect retributory under the heading of deterrence. Voltaire wrote (in 1766 and translated by someone else) that "if the death penalty is imposed for both small and considerable thefts, it is obvious that [the offenders] will try to steal much. They

[24] The correctness of this calculation is in doubt – see fn 149 at A 144.
[25] Para 222, A150.

may even become murderers if they believe that this is a means not to be detected. ... All that proves the profound truth that a severe law sometimes produces crimes." And Hannah Arendt said that "no punishment has ever possessed enough power of deterrence to prevent the commission of crimes. On the contrary, whatever the punishment, once a specific crime has appeared for the first time, its reappearance is more likely than its initial emergence could ever have been." Hefty sentences in Ponzi schemes over a century did not deter Mr Madoff or the other pyramid schemes that flare up regularly in South Africa.

64. The fact that the Legislature highlighted deterrence in this manner emphasises that the provision is not penal in the criminal sense. Furthermore, it is not overriding. What is overriding is the appropriateness of the penalty, which means that it must be balanced, proportionate and fair.

65. Deterrence in sec 167 is not a self-standing determinant but "must" be "considered" in conjunction with the degree to which the person has cooperated with the regulator in relation to the contravention; and any submissions by, or on behalf of, the person relevant to the matter, including mitigating factors referred to in those submissions. Since MetCI, in its submissions to the Commissioner, raised all the issues mentioned in sec 167(2)(b) has the effect that those issues now must be considered and that it is no longer simply a matter of discretion to consider them.

66. That illustrates the fact that mechanical checklists in determining any sanction, administrative or criminal, are problematic. Ticking the box of each element does not mean that the correct weight was attached to the element or that result is necessarily "appropriate", which is the ultimate measure. Why, for instance, the Legislature thought it wise to place "the nature, duration, seriousness and extent of the contravention" under "may" and not "must" is anyone's guess since it is the logical

starting point of the consideration of any penalty under any system. Eventually, the "appropriate" penalty, having regard to the deterrence factor, can only be assessed after consideration of all the relevant facts, whether aggravating or extenuating.

67. In reconsidering the penalty, it must be borne in mind, as we have held before *Mwale v The Prudential Authority* that:

> "***The ordinary rule is that a higher body is not entitled to interfere with the exercise by a lower body of its discretion unless it: failed to bring an unbiased judgment to bear on the issue; did not act for substantial reasons; exercised its discretion capriciously; or exercised its discretion upon a wrong principle. There is no reason why we should not apply the same approach during an application for reconsideration***."

K ASSESSMENT

68. The Commissioner was obliged to "the degree to which the person has cooperated with a financial sector regulator in relation to the contravention" but saw it as a mitigating factor whereas the FSR Act elevates it to a prime issue. There is no doubt that MetCI gave its full cooperation in relation to the contravention, providing it with all the facts necessary. The Commissioner, while recognising this, was not impressed with the fact that MetCI did not, as it were, plead guilty and submit to the proposed R175 million penalty but, instead, submitted that the facts did not prove all the contraventions and objected to the proposed penalty.[26]

69. We find that the Commissioner misdirected himself in this regard. The question of

[26] A145-146 para 199-201.

cooperation relates to providing facts. The facts of the matter were complex, as is apparent from the inspectors' reports. The disputes between the parties were genuine disputes. It can never be expected from a party in the position of MetCI to simply roll over and submit, especially if regard is had to what the inspectors demanded.

70. A further problem with the Commissioner's findings relates to the extent of the loss suffered by the Fund due to the contraventions. In the first instance, the question should have been asked what the loss to the Fund would have been had it not been for the fateful events. In other words, it was wrong to assume that the entire loss was caused by the contraventions. It is known that other funds, too, suffered losses at the time, albeit not to the same degree. That means that about 50% of the loss in value, and not 66%, might be ascribed to the Black Swan event (in its extended meaning).

71. In the second instance, although the Commissioner knew that the loss was not R175 million, he nevertheless harked back to that figure when he decided on R100 million. He also did not deal at all with the ultimate submission of the inspectors that the penalty should be somewhere between R50 million and R100 million, but apparently thought that they still proposed R175 million.[27]

72. Thirdly, we do not agree with the general snapshot approach adopted and to isolate the loss to the Fund at a specific point in time and not take a longer view to determine the loss. (The Commissioner realised the fallacy but nevertheless adopted the approach).[28] This does not mean that the snapshot is not relevant, but it cannot be decisive.

[27] A150 para 222 quoted above and A 145 para 197

[28] A145 fn 151.

73. Having said that, we agree with the Commissioner that the extent of the loss is a material – very material factor – in determining an appropriate penalty because it relates to "the nature, duration, seriousness and extent of the contravention". For present purposes, and having had regard to the submissions,[29] we will rely on MetCI's own assessment of 66% set out earlier with the discount, leaving about 50% - which remains material. It is not without significance that MetCI itself considered the matter in such a profoundly serious light that it closed down the Fund, ended its relationship with Third Circle as general portfolio manager, and introduced new control systems.

L RECKLESSNESS

74. We deal with this issue under its own heading because of the prominence given to it by the Commissioner. It is clear from sec 167 that "the extent to which the conduct was deliberate or reckless" is a factor that "may" be taken into account in determining a penalty.

75. The formulation of the provision is not really understood. The degree of culpability is always a relevant factor but why it should here be limited to "deliberate or reckless" makes little sense. What if the person was negligent? Is that not relevant factor?

76. Unfortunately, the approach of the Commissioner was that recklessness was the determining factor. We say this because of the manner in which the decision is structured. While concluding with his reasons relating to MetCI's contraventions of BN90, the Commissioner out of context turned to a discussion of recklessness as if it were a jurisdictional element of BN90[30] and long before he dealt with penalty

[29] A 64 et seq.

[30] A 126 para 110.

provisions of sec 167.[31] (By the way, his finding of recklessness appears to be limited to the contravention of BN90.)[32]

77. The strange aspect of this is that the Commissioner had found, before coming to the recklessness of MetCI, that the party factually responsible for the actions, Third Circle, was negligent – and not reckless. Since the liability of MetCI is vicarious, it is difficult to see how the fact that the Fund "might well become leveraged was . . . a foreseeable consequence" could then evolve into recklessness.[33]

78. A factor not taken into account in this regard is the fact that the Trustee, with its sophisticated compliance procedures, did not at the time notice that the investment was not compliant with BN90. We do not hereby suggest that the Trustee was negligent or reckless, or that its failures excuse MetCI, but this fact impacts on the degree of blameworthiness to be attributed to MetCI.

79. The dividing lines between the different degrees of negligence are not always possible to draw and one can use a number of adjectives to describe the one or the other but the decision as to which one applies is a value judgment based on the facts, which have to be established on a balance of probability (*Pather and Another v Financial Services Board and Others* [2017] 4 All SA 666 (SCA); 2018 (1) SA 161 (SCA)). Dealing with the meaning of "gross negligence" in a statute the Court in *Transnet Ltd t/a Portnet v MV 'Stella Tingas'* [2003] 1 All SA 286 (SCA) equated gross negligence with "recklessness in the wide sense" and said at para 7:

[31] A 133 para 162.

[32] A 137 para 166.1; A 138 para 166.11 and 12; A 148 para 213.

[33] A 108 para 35; A 111 para 48; A114 fn 35; A 121 para 87; A 126 para 108. See also A 134 para 154.

"***It follows, I think, that to qualify as gross negligence the conduct in question, although falling short of dolus eventualis, must involve a departure from the standard of the reasonable person to such an extent that it may properly be categorized as extreme; it must demonstrate, where there is found to be conscious risk-taking, a complete obtuseness of mind or, where there is no conscious risk-taking, a total failure to take care***."

80. The Commissioner based his finding of recklessness on the fact that, for an extended period, MetCI allowed the Fund to continue to invest in securities for which, in its own view at the time, it did not have reliable deltas in respect of interest rate and currency option to determine on a daily basis the Fund's effective exposure and therefore could not determine whether it was in breach of BN90.[34]

81. Assuming that sec 167 used "recklessness" in the wide sense, and not something between gross negligence and intentional, we do not believe that the Commissioner was correct in his conclusion, and that MetCI did not overstep the boundary. Much we know or what should have been known is based on hindsight. In this regard it is important to note that there existed a doubt, even in the minds of the staff of the Financial Services Board, as to the correct interpretation of BN90.

82. We have indicated that we believe that the Commissioner, in the exercise of his discretion, misdirected himself in some respects. The bigger problem is that the penalty induces a sense of shock, does not appear to be appropriate, and was imposed because of the acceptance of the submission by the inspectors that:

[34] A126 para 112 – A 129 para 125.

"***Only if an amount, large by any standard, is fixed, will it have adequate effect, or to put it more plainly, will it not make commercial sense for any other person to embark on similar schemes***."[35]

MetCI did not embark on any scheme unless the scheme is the co-naming agreement. MetCI did not and did not expect any return on the "scheme". It had no scheme to circumvent or ignore BN90.

83. The Commissioner, in our view, gave scant regard to the fact that MetCI derived no commercial or financial benefit from its conduct and, importantly, that the conduct had no effect on the financial system or financial stability. Although the contraventions were many, the overlap was extensive.

84. The result is that the decision of the Commissioner has to be set aside. We may either refer the matter back (there is a new person in the position) or determine ourselves what an "appropriate" penalty should be. The parties were agreed that we should adopt the latter approach. While it is relatively easy to say what the penalty should not have been, it is another question as to what that value call should be.

85. MetCI submitted that the doctrine of precedent applies and that like cases should be determined alike. The first submission can be rejected outright. As to the second, apart from the fact that comparisons tend to be odious, there are no "like" cases.[36] We are in virgin territory. Penalties under the repealed provisions do not, for the reasons stated, provide much by way of guideline (although a joint and several penalty of R15 million had already been imposed during 2015),[37] and we agree with

[35] A 142 para 182.
[36] B 1153 et seq.
[37] B 1156.

the Commissioner that sec 167 calls for substantial penalties. We also find no assistance from penalties imposed in other countries where there are different statutory schemes with tariffs according to which penalties are calculated.[38]

86. Two recent settlements, namely in the *Harmony* and the *Steinhoff* matters do, however, provide some guidance of the appropriate level. There are, however, important differences between these matters and the present. As to *Harmony*, the settlement amount was R30 million. There are some distinguishing aspects to highlight. The incorrect financial information was due to a mistake; Harmony had to pay a substantial amount to the US regulator; the drop in share price lasted a few days; and the shareholders would have had to carry the costs of the penalty. On the other hand, shareholders across the world were affected by the fall in price.

87. In the more notorious case of Steinhoff, a penalty of R1.5 billion was remitted to R53 million. This was the explanation:

> "***Pursuant to an agreement between the Authority and Steinhoff International Holdings NV (Steinhoff), the Authority has determined that Steinhoff has breached the provisions of section 81 of the Financial Markets Act, which deals with false, misleading or deceptive statements, promises and forecasts. The breach relates to the misrepresentation by Steinhoff of its financial performance in prior years which resulted in the restatement of its opening balance for the financial reporting period ended 30 September 2016***.

[38] For a general perspective see Yeung, Karen "Quantifying Regulatory Penalties: Australian Competition Law Penalties in Perspective" [1999] MelbULawRw 18; (1999) 23(2) Melbourne University Law Review 440 at http://www.austlii.edu.au/au/journals/MelbULawRw/1999/18.html (accessed 22 July 2020).

In terms of section 173 of the FSR Act,[39] the Authority has agreed to reduce a portion of the R1.5 billion penalty and orders Steinhoff to pay R53 million (inclusive of investigation costs) as an administrative penalty. In arriving at the amount of the penalty the Authority considered inter alia that the misstatements were material and when disclosed had a catastrophic impact on the Steinhoff share price and Steinhoff's current financial position. The Authority agreed to the reduction of the penalty to avoid penalising innocent shareholders and has reason to believe that the misstatements were because of a fraud perpetuated by Steinhoff's former officers."

88. Considering those two instances and the facts of this case we conclude that an appropriate administrative penalty would be R30 million, of one third is remitted. We do not accept the submission that a deterrent penalty need not be imposed because MetCI had not since committed the same contraventions and no one else has. Apart from the fact that is has an element of cynicism, the reason may be because of the knowledge in the market of the proposed penalty of R175 million which hung in the air for quite some time.

M DECISION

89. The application for reconsideration succeeds, and the administrative penalty imposed by the Commissioner is set aside and replaced with one of R30 million, of which one third is remitted. The amount of R20 million must be paid within two months from date of this decision together with interest at the rate prescribed for the

[39] Section 173. Remission of administrative penalties.— "The responsible authority that imposed an administrative penalty on a person may, on application by the person, by order, remit all or some of the administrative penalty, and all or some of the interest payable in terms of section 169."

time being in terms of the Prescribed Rate of Interest Act, 1975 (Act No. 55 of 1975), calculated as from 1 January 2020 to date of payment.

90. There is no costs order.

Signed on behalf of the Tribunal on 29 July 2020.

LTC HARMS (Chair)