IN THE BOARD OF APPEAL IN TERMS OF SECTION 26 OF THE FINANCIAL SERVICES BOARD ACT, NO. 97 OF 1990

In the matter between:

SPRING PERSONNEL CC Appellant

and

THE REGISTRAR OF FINANCIAL SERVICES PROVIDERS Respondent

REASONS

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1. On 15 June 2005 we issued an order upholding the appeal in this matter and indicated that we would furnish our reasons later. These are the reasons.

2. The Appellant is a close corporation called Spring Personnel CC that carries on business as a financial adviser under the name of Spring Consulting. Mrs Kim Frost is the sole and managing member of the close corporation. The Appellant will be referred to as such or as Spring Consulting and Mrs Kim Frost will be referred to as Ms Frost. The Respondent will be referred to as the Registrar.

3. On 19 February 2004 Appellant applied in terms of section 8 of the Financial Advisory and Intermediary Services Act No. 37 of 2002 (the FAIS Act) for a licence in terms of section 7 of that Act as a financial services provider. On 14 September 2004 Appellant's application was refused by the Registrar. On 17 September 2004 Appellant in the exercise of its rights in terms of section

39 of the FAIS Act noted an appeal against the Registrar's decision to this Board, i.e. in terms of section 26(1) of the Financial Services Board Act, No. 97 of 1990 (the FSB Act).

4. In his letter dated 14 September 2004 the Registrar gave two main reasons for refusing the application: firstly, Ms Frost's association with Magnus Heystek International, and secondly that at Spring Consulting she was conducting unregistered investment management activities in contravention of section 4 of the Stock Exchanges Control Act No. 58 of 1981 (SECA). The Registrar concluded by stating that in view of those findings and the fact that she had not made a full and frank disclosure of her past activities, she did not meet the honesty and integrity component of the fit and proper requirements of the FAIS legislation published in Board Notice 91 of 2003.

5. In response to Appellant's Notice of Appeal the Registrar in a letter dated 22 March 2005 again furnished reasons for his decision in terms of Regulation 4 of the Regulations published under section 26(2) of the FSB Act. In this letter the Registrar amplified his reasons but basically he reiterated his previous findings. He stated that the facts surrounding his refusal of the application could be reduced to what he termed "three critical factors", namely -

> "(a) The involvement of the key individual, Ms Kim Frost, with a company known as Magnus Heystek International (Pty) Limited (MHL) (*sic*);
>
> (b) The conduct of unregistered investment management business not only by MHL during Ms Frost's association with that company, but thereafter by Spring Consulting, without being authorised thereto by the FSB; and
>
> (c) When applying for a licence under FAIS, Ms Frost failed to make full disclosure of relevant facts relating to her past, *inter alia,* the matters referred to in (a) and (b)."

6. The Registrar stated that the basis for his refusal of the application was that Ms Frost, who was Appellant's key individual, did not, presumably for the three reasons furnished, meet the fit and proper requirements of honesty and integrity.

7. It is necessary in order to determine whether the Registrar's reasons were justified to consider the nature of Ms Frost's association with Magnus Heystek International and also the manner in which she conducted the business of Spring Consulting. She described her business as being that of financial adviser. In Appellant's application in terms of the FAIS Act she summarised her employment history as follows. From January 1992 until September 1994 she worked firstly for UAL Merchant Bank and, secondly, for Investec Bank as "broker consultant". From 1 October 1994 until 1 July 1998 she was employed by Magnus Heystek IPS (Pty) Limited as financial adviser. From 1 August 1998 until 31 December 2000 she worked for Citadel Investment Services Limited (Citadel) as "portfolio manager". From 1 January 2001 to 28 February 2001 she was employed by Magnus Heystek International (Pty) Limited as "financial adviser". On 1 May 2001 she started Spring Consulting and is still so engaged.

8. In a letter dated 1 June 2004 from Ms Davel who described herself as Analyst: Registration, Financial Advisory and Intermediary Services, Ms Frost was asked to provide the Registrar's office with the following information:

> "1. The reasons why you chose not to fully disclose your involvement with Magnus Heystek at the time of his investigation; and

2. Disclosure of any investment management business conducted by yourself, if applicable."

9. From the papers it appears that on 19 February 2002 the Registrar initiated an inspection in terms of section 3 of the Inspection of Financial Institutions Act No 80 of 1998 "into the affairs of Heystek, MHI and any other related entities". The inspectors' report was issued on 11 September 2002. In their report the inspectors made a number of adverse findings against Heystek. The inspectors also found that Heystek had contravened section 4 of SECA. The report in three paragraphs (90, 91 and 92) dealt with "Ms Frost's involvement". In paragraph 90 it is stated that Ms Frost was a director of MHI and she is still recorded as such in the register kept by the Registrar of Companies. In paragraph 90 it is stated that:

> "According to Heystek, Ms Frost was together with himself, responsible for investment decisions and instructions to financial institutions until February 2000, when she left MHI."

Paragraph 92 reads as follows:

> "From Ms Frost's application it would appear that she then started her own business called Spring Consulting CC. It would further appear from her application that she is currently conducting unregistered investment management activities in contravention of section 4 of the SECA."

10. Ms Frost responded to Ms Davel's letter of 1 June 2004 in a letter dated 7 June 2004, to which she attached an affidavit. In her affidavit she stated that she had been employed by Citadel as a portfolio manager from July 1998 to September 2000. She was approached by Heystek to leave Citadel and join MHI. She was offered a 50% share in the company and became a director.

In February 2001 she resigned as a director and left MHI to start her own business. She was not aware of the investigation until after she had left MHI. She heard about it "on the grapevine". She saw the report for the first time in April 2005 when her attorneys were furnished with a copy. She was eventually paid by Heystek for her shares after it had become necessary for her to obtain a judgment against him in the Witwatersrand Local Division of the High Court. She accordingly contends that it was not necessary for her to "disclose (her) involvement with Magnus Heystek at the time of his investigation". Her association with Magnus Heystek International had, of course, been disclosed in the application form when she summarised her employment history as set out above.

11. We now turn to the nature of Appellant's business with particular reference to whether she has contravened section 4 of SECA. The relevant portions of section 4 of SECA read as follows:

> "**4 Restrictions on managing investments**
>
> (1) No person may, as a regular feature of his or her business, undertake the management of investments on behalf of another person, and for such management receive any remuneration in whatever form, unless he or she -
>
> (a) is a person who has been approved by the Registrar .....;
>
> (b) has a written mandate to do so from the other person;
>
> ....
>
> (7) For the purposes of this section -
>
> (a) 'investments' means -
>
> .....
>
> (iii) units in a unit portfolio as defined in section 1of the Unit Trusts Control Act, 1981

.....

(b) 'management of investments' means -

(i) the buying, selling or otherwise dealing with investments on behalf of another person;

(ii) an offer or agreement regarding such buying, selling or dealing, irrespective of whether an investment manager is required to exercise his, her or its discretion; or

(iii) the implementation on behalf of another person of a decision to buy, sell or deal with investments, but not -

(aa) the giving of advice on the merits of such transactions without receiving funds or assets from a client; ....."

12. In her evidence before this Board Ms Frost explained how her business was conducted. Having obtained all the necessary information concerning a client's financial position she would make recommendations as to how the client's money should be invested. Should the client agree to the recommendations, he/she would sign a form instructing the Linked Investment Service Provider (LISP) to buy or sell units in the recommended portfolios. A new client would sign a form supplied by the LISP which included a section appointing "Spring Personnel CC/Kim Frost" "as my financial adviser". A client who had previously used another financial adviser, would sign a form containing the heading "Change of Servicing Consultant". By signing this form the client appoints "Spring Personnel CC/Kim Frost" "as my financial adviser" with authority, *inter alia* to - "give instructions regarding my investments and authorise the investment administrators to execute such instructions without requiring my signature." The document also contains a clause reading:

> "This power of authority relates to switching of investments, changing of my investor details, and repurchases of my investments."

Finally the client agrees "to an annual service fee of 0,8% of the value of my investment portfolio, chargeable monthly to be levied."

13. In her evidence Ms Frost sought to draw a distinction between a new client, i.e. one who did not already have investments, and a client who was changing from an existing financial adviser to Appellant. A new client was asked to sign an application form supplied by the LISP. The client also authorized the Appellant to obtain information in respect of his/her investments in order for a "holistic" assessment to be made of the client's requirements prior to making recommendations with regard thereto. Apart from the application form a new client also signed a form in terms basically similar to those contained in the change of servicing consultation form. Ms Frost explained that she did not handle the client's money. If an investment was to be made or changed any payment was made by the client directly to the finance house concerned which was always a LISP. She explained further that she received an initial commission of 2% based on the value of the funds invested in respect of a new client, When she replaced an existing financial adviser she did not charge this initial commission as the client would already have paid commission to the former adviser. In addition to the initial commission paid by the client, she received, from the LISP, an administration fee of 0,5% based on the value of the investments under administration.

14. As envisaged in the form signed by a client when appointing Appellant as his/her financial adviser, it sometimes became necessary for the client's investments to be switched from one type of investment to another. Ms Frost testified that she effected ten switches by signing the switch form herself, one while at MHI and the remainder at Spring Consulting. Although the form signed by the client authorised her to effect a switch without requiring the client's signature,she testified that she never switched a client's investments without the client's express authority. Normally the client's authority was obtained in writing. There were, however, rare occasions ie the 10 referred to above, where she herself signed the switch instruction, but always after she had received the client's oral or written authorisation. She pointed out that the switch forms that the LISP's required to be signed made provision for "Signature of Advisor/Client".

15. From the beginning of 2002 the situation changed. On 16 November 2001 Investec Management Services (Investec) which was a LISP with whom Appellant dealt, issued a Practice Note (Practice Note 106) directed to financial advisers. The notice stated that as at 1 January 2002 two pieces of legislation come into effect which aim to improve the quality of the investment process. (Although the two legislative enactments were not mentioned, what the notice referred to was presumably the FAIS Act and the Financial Services Ombudschemes Act (FSOS)). The notice went on to point out that SECA requires financial advisers who sign and submit investment instructions on behalf of their clients to be registered investment managers, which

necessitated an application to the FSB for registration. The circular ended with the following statement:

> "As from 1 January 2002, Linked Investment Services Providers will not be in a position to action any instructions that are signed by financial advisers who are not registered investment managers."

16. This led to Ms Frost applying to the FSB on 22 January 2002 for registration in terms of SECA as a financial manager. It was not until 18 May 2004 (after several letters had passed between Appellant and the Registrar's office) that Appellant was advised in a letter from the Registrar that it had been decided not to proceed with her application in terms of SECA for three reasons:

> "1. There has been new legislative development ...With the advent of the Financial Advisory and Intermediary Services Act, 2002 (the "FAIS Act") we ceased to process applications in terms of the SECA. Applications are now processed in terms of the FAIS Act .
>
> 2. The information furnished in your application depicts the business that you are involved in as financial advisory [rather] than investment management business. For this reason your application must be lodged in terms of the FAIS Act.
>
> 3. Your compliance with the fit and proper requirement is not yet established. This is due to your involvement with Magnus Heystek International (Pty) Limited and Magnus Heystek (Pty) Limited. This is however nearer to being resolved."

The letter ended with the following advice:

> "You are advised to submit your application in terms of the FAIS Act. You have until 30 September 2004 to obtain your licence in terms of the FAIS Act."

17. Appellant's application for registration in terms of section 8 of the FAIS Act had by that time already been launched on 19 February 2004.

18. Ms Frost has at various times e.g. when applying for registration under SECA described the business she was conducting as "management of investments". However, as appears from her evidence, what she was doing was advising her clients concerning their investments and in the event of her advice being accepted, handing to the LISP in question the client's cheque together with instructions signed by the client. The only occasions on which a client's signature was not obtained were those, which were few in number, where she implemented a switch pursuant to the client's oral instruction. These occurred prior to the change in industry practice referred to above.

19. In ordinary parlance Ms Frost was in fact managing her client's investments. When a client followed her advice she monitored the client's investments and furnished advice on an on-going basis. It does not follow, however, that what she did and what she variously described as managing her client's investments, amounts to "management of investments" as defined in SECA.

20. In section 4(7)(b) "management of investments" is defined as meaning any one of three different activities. It means, in sub-paragraph (i) of section 4(7)(b), the buying or selling of investments on behalf of another person. Except for the few occasions when she personally executed a switch that was not signed by the client, she did not buy or sell investments on behalf of a client; she merely acted as an intermediary between the client and the LISP. In sub-paragraph (iii) of section 4(7)(b) management of investments is defined as meaning the implementation on behalf of another person of a decision to buy or sell investments. What she was doing cannot be described as

"implementation". Her conduct as an intermediary was akin to that of a messenger who delivers a cheque together with the drawer's instructions to the financial institution concerned.

21. Counsel for the Respondent submitted that Ms Frost fell within the definition contained in sub-paragraph (ii) of the section. In that sub-paragraph management of investment means "an agreement regarding such buying, selling or dealing irrespective of whether the investment manager is required to exercise his/her discretion". "Such buying, selling or dealing" refers to the buying,selling or dealing in sub-paragraph (i) i.e. the buying, selling or dealing on behalf of another person. Respondent's counsel submitted that by obtaining a client's signature to the change of servicing consultant form, or its equivalent, Ms Frost was entering into an agreement covered by sub-paragraph (ii). We agree with this submission. It must be borne in mind, however, that Ms Frost's undisputed evidence was that this particular form was "a standard industry form". Moreover, although this form constituted an agreement regarding the buying and selling of investments on behalf of a client, Ms Frost did not in fact exercise the right given to her in terms of the document, to buy or sell on behalf of a client. Even in the few cases where – prior to the change in industry practice - she signed a switch instruction, she did not act without the client's express authorisation, whether in writing or otherwise. Her breach of this sub-paragraph could in the circumstances be described as technical.

22. The ultimate question to be answered is whether Ms Frost complies with the requirements for fit and proper financial services providers as determined by Board Notice 91 of 2003 in respect of "personal character qualities of honesty and integrity" (section 8(1) of the FAIS Act). Ms Frost's conduct does not fall within any of the categories of conduct set out in section 2 of the Board Notice that constitutes *prima facie* evidence that she does not qualify as a person who is honest and has integrity. Her breach of section 4(7)(b)(ii) of SECA was, as indicated above, of a technical nature. The remaining grounds on which her application was refused by the Registrar were, firstly, her association with MHI and, secondly, her alleged failure to make a full and frank disclosure concerning her past. As far as her association with Magnus Heystek is concerned the Registrar's counsel very fairly conceded that the complaint regarding such association involved no more than that she was, while so associated, conducting herself in contravention of section 4 of SECA in the sense described above, which, as already indicated, was merely technical. There is no merit in the Registrar's last reason; throughout her dealings with the Registrar and his office she has been fully open and frank.

23. With regard to the costs the Registrar's counsel argued that if the appeal succeeded, costs should not be awarded against the Registrar as his action in refusing the application had been reasonable. We do not agree. There is no reason why the normal practice that the costs follow the result, should not apply.

24. For these reasons we came to the conclusion that the Registrar's refusal to register the Appellant was not justified and that the Appellant complied with the requirements for registration in terms of section 8 of the FAIS Act. We accordingly issued an order reading as follows:

> "1. The appeal is upheld and the Registrar's decision is set aside.
>
> 2. The Registrar is instructed to issue Appellant with a licence in terms of section 8 of the Financial Advisory and Intermediary Services Act, No. 37 of 2002.
>
> 3. The Registrar is ordered to pay Appellant's costs of the appeal. The deposit paid by Appellant in terms of the Regulations under the FSB Act is to be retained by the Registrar."

DATED at Capetown this 27th day of JUNE 2005.

G FRIEDMAN
Chairperson

J PEMA
Member

H D McLEOD
Member