IN THE FINANCIAL SERVICES BOARD OF APPEAL

In the appeal of :

HAMILTON SMITH & CO. (PTY) LTD **Appellant**

and

THE REGISTRAR OF FINANCIAL MARKETS **Respondent**

DECISION

INTRODUCTION

1. The appellant is a company called Hamilton Smith & Co. (Pty) Ltd. Its sole shareholder is Wayne Hamilton Smith ("Smith"). Smith is a director of the appellant. Roger Pearce ("Pearce") is the only other director. He is a non-executive director. On 16 May 2002 the appellant applied to the respondent, the Registrar of Financial Markets ("the Registrar") for approval in terms of the Financial Markets Control Act No. 55 of 1989 ("the Act") to act as an investment manager. The application was refused by the Registrar. This appeal lies against that refusal.

THE RELEVANT PROVISIONS OF THE ACT AND THE NOTICE

2. Section 5(1)(a) of the Act provides that –

> "(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 or is a person who falls within a category of persons approved by the Registrar."

3. Section 5(3) of the Act provides that –

> "(3) Every application for approval referred to in subsection 1 shall be made in the prescribed manner and shall be accompanied by the prescribed application fee".

4. The relevant provisions of section 5(4) of the Act read as follows –

> "(4) The Registrar may grant an applicant the approval contemplated in subsection (1) if –
>
> (a) The applicant is of good character and integrity, or in the case of a corporate body, is managed and controlled by persons who are of good character and integrity;

(b) The applicant complies, or in the case of a corporate body is managed by persons or employs persons who comply, with the standards of training and experience and the other qualifications required by the Registrar by notice in the *Gazette*;

(c) The applicant complies with the prudential requirements determined by the Registrar by notice in the Gazette."

5. By Government Notice 1583 of 2001 the Registrar, under section 5(1)(a) of the Act, set out the conditions with which a person who manages investments on behalf of another must comply. The same Notice contained, in terms of section 5(4)(b) and (c) of the Act, the standards of training, experience, other qualifications and prudential requirements with which a person who manages investments on behalf of another must comply.

6. The application was limited to seeking approval to manage investments consisting of units in a collective investment scheme. This is one of the categories of investment that the Registrar may approve a person to manage (see condition 3.3). Condition 13.5 provides that an investment manager may only appoint a natural person as an authorised representative if such a person possesses one or more of the qualifications and the corresponding experience set out in a Table contained the Notice. In terms of the Table, a person with the qualification reading "Investment Advice and Investment General prescribed by the South African Institute of Stockbrokers" is required to have two (2) years experience. Smith is the only person in the appellant company who would

be responsible for the management of investments, should this appeal be successful. He has the necessary qualifications and experience required in terms of Condition 13.5. Consequently the question on which this appeal hinges, is whether section 5(4)(a) of the Act has been satisfied ie. whether appellant has established on a balance of probabilities that Smith, who would manage and control appellant is "of good character and integrity". It was on this ground that the Registrar refused to grant his approval.

THE NATURE OF THE APPEAL

7. This appeal is brought in terms of section 26 of the Financial Services Board Act No. 97 of 1990 ("the FSB Act"). Section 26(7) of the FSB Act provides that for the purposes of an appeal, the Commissions Act No. 8 of 1947 shall apply to the Board of Appeal, witnesses and their evidence as if the Board of Appeal were a Commission. The procedure at the hearing of an appeal shall be determined by the chairperson (section 26(8)). The Board of Appeal may confirm, set aside or vary the decision against which the appeal is brought or may refer the matter back for consideration or reconsideration by the Executive Officer in accordance with such directions as the Board of Appeal may lay down. These provisions make it clear that an appeal in terms of section 26 of the FSB Act is an appeal in the fullest sense ie. a complete rehearing of and fresh determination on the merits of the matter. cf Tickly and Others v Johannes N.O. and Others, 1963 (2) SA 588(T) at 590. Accordingly this Board must itself determine *de novo* whether approval in terms of section 5(4) of the Act may be granted.

GOOD CHARACTER & INTEGRITY

8. To determine whether a person is "of good character and integrity" involves a moral judgment. In arriving at that judgment it is necessary to have regard to the manner in which the person concerned has conducted himself not only in his private life but also in his dealings with those with whom he has come into contact professionally or in the course of his business. A distinction is sometimes drawn in this context between "character" and "reputation". As Lord Denning put it in Plato Films, Ltd v Speidel, [1961] (1) All ER 876 at 889 :

> "A mans 'character', it is sometimes said, is *what he in fact is*, whereas his 'reputation' is *what other people think he is*."

In Ex parte Tziniolis [1967] (1) NSWR 357 Holmes J A at 377 described the term "good character" as follows :

> "'Good character' is not a summation of acts alone but relates rather to the quality of a person. The quality is to be judged by acts and motives, that is to say, behaviour and the mental and emotional situations accompanying that behaviour. However, character cannot always be estimated by one act or one class of act. As much about a person as is known will form the evidence from which the inference of good character or not of good character is drawn." (emphasis supplied).

9. The relevant definition of "integrity" in the Oxford English Dictionary reads :

> "3b. Soundness of moral principle; the character of uncorrupted virtue, esp. in relation to truth and fair dealing; uprightness, honesty, sincerity."

10. These definitions suggest that in determining whether a person is "of good character and integrity" it is necessary to know as much as possible about that person and his or her background or, put differently, to know "the whole person".

The Conditions laid down by the Registrar in Notice 1583 of 2001 are to the same effect. Thus, the relevant portion of Condition 6, under the heading "Duties of an Investment Manager or LISP," reads as follows :

> "An Investment Manager or LISP must –
>
> 6.1 when applying for approval, disclose complete details of the career history of its authorised representatives;
>
> 6.2 when applying for approval, fully disclose information to the Registrar about any matters in which its owners, directors, members, shareholders, authorised representatives or trustees were involved, which information might be relevant in the Registrar's assessment of the good character and integrity of the investment manager or LISP to manage investments."

SMITH'S HISTORY

11. Smith is 38 years of age. He left school at end of 1982. In 1983 and 1984 he completed his National Service in the Air Force. He then studied graphic design at the Witwatersrand Technikon, graduating at the end of 1987. From January to June 1988 he worked as an assistant art director for an advertising agency. From June 1988 to 1993 he worked as a graphic designer / freelance artist providing consulting services to the advertising industry. In 1992 he met one Antoine Manachi ("Manachi") who was at all material times the chairman and chief executive officer of a company called Proplace (Pty) Ltd ("Proplace"). In 1993 Smith and Manachi formed a close corporation called Adworks CC in which each had a 50% interest. Smith was to manage the CC while Manachi was to finance the working capital. Adworks was to provide graphic design and advertising services primarily to Proplace, although Smith was, through the CC, permitted to pursue other work.

12. Smith's association with Manachi led to his becoming involved in the business of Proplace. He states in Annexure "D" to the application :

> "At the same time (June 1993) in order to cement the relationship, I was appointed a non-executive director of Proplace."

It will be necessary in due course to deal in more detail with Smith's evidence as to his directorship of Proplace. Suffice at this stage to quote what is stated at page 43 of his application. Having said that in June 1993

he was appointed a non-executive director of Proplace, he proceeds as follows :

> "In November 1994 it was agreed that Adworks CC would cease trading. It had not been as successful as we had hoped. During the period of our association, I had developed an interest in and knowledge of the Proplace business. Accordingly, Mr Manachi offered me the position as an executive director responsible for marketing of Proplace, which position I accepted. Within three months, it became apparent that I would not be allowed the freedom to act as a marketing director, nor was there any room within Proplace for a "management team" as Mr Manachi retained total control. At the time, I was getting more involved in the sale of products, developing demonstration tools and the like. As a consequence, I resigned as an employee and director of Proplace and became an independent sales consultant. At that time a couple of other people also resigned as directors, for similar reasons. The consequence of all this was that I ceased to be paid a salary and was never invited, nor attended any board meeting at Proplace again. All my income from then on was commission based (from Proplace and other institutions such as Sanlam and TMA [Fedsure])."

PROPLACE'S BUSINESS

13. Proplace's business consisted of seeking clients who were prepared to invest in the investment scheme devised by it. The main recruitment of clients was done by the tele-canvassing staff. They would, as the name

implies, telephone potential clients, advise them that Proplace could assist them to reduce their income tax or could provide them with investment opportunities and seek to interest them in investing with Proplace. If a potential client expressed interest in what Proplace had to offer, the tele-canvassing staff would set up an appointment for a consultant to call on the client with a view to securing an investment from the client in one or other of Proplace's investment schemes. One of these schemes was known as the "assured option". How this scheme was marketed and how it was implemented will be dealt with presently.

14. In March 1998 Roger Cameron Ellis ("Ellis"), a partner in Deloitte and Touche, was appointed by the Registrar of Banks to investigate whether Proplace and / or Manachi were conducting the business of a bank. On 14 May 1998 Ellis reported to the Registrar of Banks that the business of a bank was indeed being conducted. Neither Proplace nor Manachi held a licence to conduct such a business. Upon receipt of Ellis's report and on 27 May 1998, the Registrar of Banks appointed Ellis as a Fund Manager in terms of section 84(1) of the Banks Act "to oversee the repayment of money unlawfully obtained from the public by Antoine Manachi, Proplace (Pty) Ltd and Proplace Investments (Pty) Limited and their associates".

15. In his report to the Registrar of Banks on 14 May 1998, Ellis described the mechanics of Proplace's investment scheme known as the assured option. The relevant portion of the report reads as follows :

> "3.2 When an investor invests in the scheme, there are, generally, two broad scenarios,

Scenario 1 :

- The investor entered into an agreement in terms of which the investor invests an amount with Proplace (Pty) Ltd for a period determined by the investor;
- Proplace (Pty) Ltd undertakes to repay this amount to the investor at the agreed future date and at the agreed growth rate of normally between 12% and 16.5%;
- Simultaneously to the above agreement, the investor enters into a second agreement in terms of which the investor proposes to purchase a specific endowment policy. According to the agreement, Proplace undertakes to purchase this policy from the investor in the future, at a pre-determined date and a pre-determined price. This pre-determined price is usually equal to the amount invested plus a growth of 12 - 16.5%;
- As and when the investor invests his money, Proplace purchases the policy on behalf of the investor and the investor becomes the owner of the policy. This policy is then the underlying security for the investment and Proplace is responsible for the payment of the premiums on the policies;

..."

Scenario 2 :

- The investor enters into an agreement in terms of which the investor invests an amount with Proplace (Pty) Ltd for a period determined by the investor;
- Proplace (Pty) Ltd undertakes to repay this amount to the investor at the agreed future date at an agreed interest rate of normally between 12% and 16.5%;
- Proplace (Pty) Ltd does not cede any policies to this investor and neither is a new policy purchased by either the investor or Proplace on his behalf;

..."

In paragraph 3.4 of his report Ellis stated :

"When an investor is involved in an investment situation similar to scenario 1 as discussed above, ie. There is an endowment policy as underlying security for the investment, Proplace would monitor the claim value attributed to the policy (themselves), on a quarterly basis. If, in the opinion of Proplace, the value of the policy would exceed the investment, the investor would be informed of this and requested to cede the policy to Proplace. A policy consonant with this investment would then in return be ceded to the investor ..."

In paragraph 3.5 of the report Ellis explained that :

"It was noted that whenever an investor issued cheques to initiate the investment, the cheques were either issued to Proplace (Pty) Ltd only or, to both Proplace (Pty) Ltd and the relevant insurance company (where a policy was purchased on behalf of an investor).

The cheque issued to Proplace is deposited to Proplace's bank account and the cheque issued to the insurance company is utilised to pay any of the numerous premiums due on any of the endowment policies Proplace has to service on behalf of investors or in some instances to make the first annual premium on a new policy..."

Ellis went on to explain that in practice, the scheme was never carried out as it had been represented to the client.

Then In paragraph 3.6 he states :

"In terms of the mechanics of scenario 1, as explained above, whenever a client invests money with Proplace, Proplace undertakes to purchase a policy, new or second hand, on behalf of the client, to serve as the underlying security for the investment. However, this is not always the case. We have identified three possibilities where investors do not have their own, or have inadequate underlying security :

- Clients with smaller investments are not issued with policies in their own name. They are all linked to one or more of the larger policies. Thus one large policy serves as their underlying security for a number of investors without these investors actually having any interest in the policy;
- Investors who had policies issued in their own names were given the undertakings that the premiums of these policies were to be paid by the proceeds on certain other policies.

Again large policies in which the investors had no interest were presented to investors as the underlying security for the premium obligation (not for the investment);

- In other instances the same policy served as both the underlying security for the investments and premium obligations of different investors without any of the investors having an interest in the policy."

16. According to Ellis's report to the National Director of Public Prosecutions on 11 June 1999, possible offences were committed. He states that investors total claims against Proplace amounted to R188 986 957.00 and the maximum dividends available amounted to R140 260 822.00, leaving a deficit of R48 726 135.00.

17. Marius Nicholas Alberts ("Alberts") an attorney who is employed at Deloitte & Touche's forensic department, called as a witness on behalf of the Registrar during the appeal, testified that he had assisted Ellis in the Proplace investigation. Alberts extracted from the records of Proplace, details of investments obtained by Smith during the time that he was selling investments on behalf of Proplace. The schedule he prepared (Bundle "B" page 5) shows that Smith acted as an investment agent on behalf of Proplace for approximately 47 investors who invested, in the aggregate, an amount of R6 134 467.00. The total dividends they have received amounts to R3 044 571.00. Their loss thus amounts to R3 079 896.00, less a possible further insignificant dividend of less than 0.01c in the Rand.

18. In terms of the assured options contracts with Proplace, the underlying security offered to the investor was an endowment insurance policy. However, as Alberts explained, investors were not always allocated a specific endowment policy. Thus not all the investors had security. Some had an "interest" in a so-called "block policy" ie. a policy in the name of Proplace or Manachi in respect of which Proplace undertook to cede to the client a portion of the insured amount. Needless to say, such cessions were valueless and provided no security at all. Moreover, the so-called block policies were ofteen seriously over subscribed, eg. portions of one policy worth R1 300 000.00 was found by Alberts to have been ceded to investors for many millions of Rands. Alberts explained how the assured options scheme was supposed to work. He testified, however, that in practice it did not work as it was supposed to. He proceeded to explain this as follows :

> "People were not allocated their specific endowment policies. In other words, not every investor had a second-hand endowment policy. It varied. [Some] had a block policy as their security. Some people had no policy. Some people had a policy in their name of which the value was less than the investment. Proplace also entered on behalf of the investors, in to numerous agreements with insurance companies where they purchased new policies and paid the premiums on behalf of the clients. I mean this thing was never, the administrative side of things were never as I have explained. In other words there was never this exact link all the time between the new policy, the second-hand policy and the investor. It was a circle of cessions of policies purchased, new policies, utilising money to pay

the premiums. It did not work for the investors as I had explained the theory".

WHAT ROLE DID SMITH PLAY ?

19. Smith testified that he marketed the assured options investments from June 1995 until Proplace ceased operating in May 1998. During that period he acted, according to Alberts, as investment consultant to 47 investors, representing them in 87 transactions involving a capital amount of R6 134 467.00. Proplace targeted elderly people. Smith testified that Proplace's clients were either retired or close to retirement. Many were not financially literate. He conceded that dealing with elderly people who were not financially literate, placed a heavy responsibility on him as an investment advisor. In his evidence in chief Smith explained how he dealt with clients who were prepared to invest in one of the assured options schemes. His evidence reads as follows at page 38 :

"Yes, essentially what would happen is once the investment itself was or the intent was to go ahead with the investment, I would meet with the investor. They would complete an application form for the investment where all their details were put down. At that point in time a cheque was made payable either to an insurance company or to Proplace, depending on the circumstances and we would get advice from the staff at Proplace prior to making an investment at the time, which was more suitable. Then we would, once we have received that cheque, we would issue the client with a Letter of Intent which basically stipulated the details of the investment and how it would be structured. The time of roughly about two to three weeks would

elapse before we would actually produce the contract. That enabled Proplace to basically place whatever insurance policy is needed to be placed with the insurance companies and receive those underlying policy contracts which would form part of the Proplace agreement. So when I went back to see the client, essentially I would take with me an endowment policy contract from an insurance company, together with a contract beginning on page 51 for example which would stipulate the details or the conditions of the investment between the investor and Proplace."

An example of the contract to which Smith referred reads as follows :

"Whereas the clients proposed to purchase a life insurance policy with Sanlam, being policy number 16441546X5, which policy contract will form part of this agreement and the clients are desirous to obtain additional security for any exigency which might occur, and the company is prepared to provide this security.

1. The parties hereby agree as follows :

1.1 At the expiry of a term of 60 calendar months from the date of this agreement, the clients have an option to sell the policy to the company for an amount of R429 199.91. This option shall lapse if not exercised within a period of 30 days after the expiry of the aforesaid 60 calendar months.

1.2 In the exercise of the option, both the clients and the company must give the other party one calendar months written notice of its intent to exercise the option.

1.3 It is further agreed by the parties that the company hereby acts as guarantor for the purchase price payable by the company on the exercise of the option, either by the clients or by the company.

1.4 The company hereby undertakes to make payment of all premiums becoming due on the policy for the duration of this agreement."

There was no reference in his evidence in chief when he explained how the system worked, to the fact that in many instances the security was not an endowment policy in the client's name, but an interest in a block policy which he knew represented no security. The pitfalls in the system and how it was marketed by Proplace's sales consultants, which included Smith, emerged only from his evidence in cross-examination.

20. Presumably because of his background in advertising and graphic design, Smith was the author of the demonstration tools used by himself and the other consultants in their presentation to potential investors. One of these, headed "Our recommended strategy" has a logo which mentions "risk" as one of the components of the strategy. Yet when Smith endeavoured to persuade a potential client to invest in an assured option scheme, he paid scant regard to the question of risk. When asked whether he alerted potential investors to the risk of investing in this scheme, he replied that if

he ever believed that there was any risk involved, he would not have recommended the investment. He testified that as the assured option was a product which used endowment policies as the underlying investment and that he was not concerned about the ability of insurance companies like Old Mutual or Sanlam to be able to effect payment in terms of those policies, he did not consider that there was any risk involved. He admitted that he probably told potential investors that there was no risk involved as their security was a policy with well known companies and that in that way he succeeded in creating a certain amount of trust with clients. Moreover giving a client an interest in a block policy appears to have been the preferred form of security offered. According to Alberts, consultants received a higher commission if the cheque obtained from the client was issued to Proplace rather than to an insurance company.

Questioned, in this context, about interests in block policies in the name of Manachi which were offered to clients as their security, Smith admitted that he knew that if an investor had bought rights in a block policy, the policy could not be ceded to him and that as there was no cession there was no security.

21. Smith testified that he was satisfied that there was nothing wrong with the manner in which Proplace operated as the sales consultants had been given assurances to that effect by Manachi. In this regard, he said that they were told by Manachi that Proplace had an opinion from senior counsel and that the Proplace investment scheme did not contravene the Income Tax Act. Manachi also told them that he had a letter from the Reserve Bank "basically indemnifying Proplace at that particular point in

time." These documents, Smith stated, "were produced over time during sales meetings at Proplace". The opinion from senior counsel was obtained in 1990. The opening paragraphs of the opinion read as follows :

"In my view, if an investor acquires a 10 year endowment insurance policy, as envisaged in the evaluation, and holds the policy to maturity, the proceeds of the policy will be free of tax in the hands of the investor.
If the investor sells his interest in the policy, pursuant to the option granted to him by Proplace, the proceeds of the sale, would, likewise be free of tax, as long as it is not the intention of the investor, from the outset, to exercise the option.

It might be different if, from the outset, it was the intention of the investor to sell the policy at the end of 5 years. In such a case there are two possible bases upon which the Commissioner might seek to tax the proceeds of the sale."

Counsel is not saying anything more in this opinion than that, if the investment scheme was conducted as counsel had been told it was, the client would not be liable to tax on the enhanced value of his policy at the end of 10 years. Any reasonably intelligent sales consultant at Proplace – and Smith was certainly sufficiently intelligent – would have realised that counsel was in no way giving Proplace the "green light" to conduct its business in the manner in which it did.

The letter from the Reserve Bank is dated 30 September 1990 and is signed by the Registrar of Banks. It reads as follows :

"After careful consideration of the documentation furnished to us in respect of the investment transactions conducted by Proplace (Pty) Ltd ("Proplace"), this Office wishes to advise that suspicion no longer exists that Proplace appears to be or to have been conducting the business of a Bank without having been registered as a bank in terms of the Provisions of the Banks Act (No. 94 of 1990)".

This letter says no more than that the Banks Act was not being contravened by Proplace. Neither counsel's opinion nor the letter from the Registrar of Banks justified the manner in which Proplace's business was in fact being conducted. Smith initially said that he had "glanced through" counsel's opinion. He went on to say :

> "I didn't have access to the opinion at the time, although I do think once again it was quite some time ago, I know that during my time at Proplace, at one stage I did read that opinion yes."

22. Although Smith knew that to give an investor an interest in a block policy did not provide the investor with security, he nevertheless attempted to sell investments secured by such a policy. He testified that he explained to clients when he explained the contract to them that a portion of the capital would be invested in a block policy. If clients were unhappy about that, an endowment policy in the client's own name would be issued to the client. His explanation of how he presented the assured option to the clients appears from the following passage in his evidence at page 100:

> "I never tried to sell the block policy to anybody. I explained to the clients that this is the structure that is normally done. Are you comfortable with that? If the clients are not comfortable with that and they wanted their own security, we would endeavour to provide policies for them that gave them their security that they were looking for."

Having said that, if a client was dissatisfied with that explanation, a policy in their own name would be given to them. He offered to demonstrate such a situation. He referred to the contract entered into with his client Roberts. That contract refers to an Old Mutual policy number 70004678553298.

Smith conceded, however, that the Old Mutual policy was a block policy and that that did not appear from the contract. He then said that he would point to a contract which identifies the security as being a block policy. He said that the contract with his client Ashton was an example of such contract. That contract does not state that the client's security is a block policy.

In the top right-hand corner of the coversheet of this agreement there is typed "ASHOM9112135". That, said Smith, was a block policy. He agreed that there was no indication in the contract that the underlying security for Ashton's investment was a block policy. He said, however:

> "... the policy number at the top right-hand corner was Proplace's way of indicating that this was a block policy ...."

The second page of the Ashton contract contains a diagram indicating how a Southern policy will increase over 5 years to R140 808.00 on Ashton's investment of R70 000.00. A second diagram below that shows how the Old Mutual policy number 9112135 would decrease in value over a similar period. That diagram, Smith contended, explains to the client that the Old Mutual policy is a block policy. Apparently what normally happened when a client indicated that he was prepared to invest in an assured option scheme, the administrative staff would decide what policies should be utilised for that client's contract. Normally clients would be offered a block policy as security and Smith conceded that he did try to sell them an investment secured by such a block policy.

SUMMARY

23. What emerges from the evidence may therefore be summarised as follows :

(1) It was Proplace's policy to offer an interest in a block policy as the underlying security for a client's investment.

(2) Only if the client expressed dissatisfaction with that type of "security", was an endowment policy in the client's own name offered to him.

(3) Smith knew that a block policy provided no security. He maintains that he explained to clients the difference between an endowment policy in their own name and an interest in a block policy.

(4) Many of his clients invested in a block policy.

(5) It is highly improbable that these clients would have been content to accept an interest in a block policy as their underlying security if it were properly explained to them that such policy offered no security.

(6) It is accordingly improbable – and we cannot accept – that Smith would have explained to his clients that if they accepted an interest in a block policy, they would have no security for their investment.

24. Smith attempted to justify his selling of investments not properly secured, by stating that the investor's security was their contract with Proplace in terms of which they have rights to the block policy. In other words the extent of an investor's security, if his "security" was an interest in a block policy, depended on Proplace being able to meet its obligations in terms of its contract with the investors. That in turn depended on Proplace's liquidity and financial position which Smith never questioned. His confidence in Proplace rested, according to him, on the fact that until the collapse of the company in May 1998 it had never failed to meet a claim. In other words, Smith was content to represent to a potential client that his or her security was an interest in a block policy which he knew was no security and to leave it to a potential investor who was sufficiently intelligent to enquire as to the nature of the security being offered, to insist on obtaining valid security rather than the so-called security being offered by Smith. Even if the investor was offered an endowment policy as the underlying security for his investment, the investor's ultimate security lay in Proplace's ability to meet its obligations at the expiry of the agreed period. These policies, which were identified by the Proplace staff as being suitable, were supposedly serving as the underlying security for contracts between Proplace and the investors. The contracts guaranteed annual

returns of between 12% and 16.5% whereas, according to Smith, the insurance companies underwriting the policies were illustrating possible values at annual rates of 11% and 14%. Moreover, as the policies were equity linked, the insurance companies could give no guarantees. Smith was aware of the risk that this entailed. As he said at page 181 of the record, "Well there was always the risk of Proplace defaulting". In acknowledging that the policy itself was not a sufficient guarantee, Smith fell back, as justification for selling such investments without disclosing to his clients the risk involved, on the fact that Proplace had never failed to meet its obligations.

25. Smith testified that he kept in touch with the clients to whom he sold investments. He was under the impression that Proplace sent periodic statements to his clients giving them a value of their investments. Smith himself was given a copy of such a statement only if he requested it. He did not think it necessary to check those statements, because when he from time to time checked the statements, he saw that they were true and correct. However, it appears that when he was asked by a client for the value of the security, he was content to send the client a "valuation" which was not obtained from an insurance company, but was a "valuation" obtained from the officials at Proplace. That so-called "valuation" was no more than a calculation of the amount of the investment with interest at the agreed rate over the period of the investment. Smith's justification for this is that the administrative staff at Proplace were "perfectly competent people" and that he had no reason to disbelieve the valuation that they had given him. This is a naïve explanation which is unacceptable from a person who purports to be prudent and proclaims to be interested in the

welfare of his clients and the strength of their security, particularly having regard to the fact that Smith knew that the surrender values of the policies were considerably less than the values provided by Proplace.

26. Smith was clearly aware, both when he launched this application, as well as when he testified before this Board, that if he had an Achilles' heel, it was his association with Proplace and the manner in which he conducted himself during that period. He was accordingly at pains to distance himself as far as possible from any position of influence in the company. An illustration of this is the way in which he attempted to explain his directorship.

On 8 June 2000, Smith applied under the Act and under the Stock Exchange Control Act 1985 for approval for his company ("the appellant") to act as an investment manager in respect of unit trusts. In a letter dated 23 May 2000 addressed to the Financial Services Board Smith said:

"1. I was employed by Proplace in January 1995 as a non-executive director of marketing. This resulted from the voluntary closure of my marketing company at the end of 1994 in which the owner of Proplace and I were partners. The reason for the closure was the need to put all my attention into Proplace, which was a successful company with the owner wanting to grow the business further.

2. Within 3 months it became apparent that my role as marketing director was unsuited to the owner who was unwilling to allow me the freedom to implement an effective marketing strategy and I found

myself merely developing sales aids for the sales consultants within the company. At this point I resigned my position and moved into sales".

In the present application he said that in June 1993 he was appointed as a non-executive director of Proplace. In November 1994 Adworks CC ceased trading. He was then offered the position "as an executive director responsible for marketing for Proplace". After three months, he said, he "resigned as an employee and director of Proplace and became an independent sales consultant." Although he stated categorically in both of his applications and his evidence that he had resigned as a director, according to the official records he remained a director and is still registered as such. He testified :

> "I resigned my position as marketing director to Tony Manachi in March 1995".

He went on to say :

> "At that point in time I'd neglected to have my name removed at the Registrar of Companies as a company director."

When asked to explain the difference between what he had said in his first application, namely that he had been appointed as a non-executive director and had made no mention of his having being appointed as an executive director as stated in the present application, Smith stated that he was ignorant of the difference

between an executive and a non-executive director. He conceded in cross examination, however, that by describing himself as a non-executive director, he was attempting to "put my best foot forward", although he added that he also did not have a full understanding of what is meant to be a non-executive director.

27. Whatever his understanding was of the difference between an executive and a non-executive director, as a fact his name continued to appear on Proplace's stationery as a director. Moreover, on the sales aids which he designed for sales consultants and which were utilised by him when seeking to interest potential investors, his name continued to remain as a director, despite the fact that other names were changed from time to time as the directors changed. The witness Badenhorst, who was called by appellant, testified that Smith had told him late in 1997 that he was a director of Proplace. The evidence shows that as long as it was to his advantage to do so, Smith represented to potential clients that he occupied the position of director and that even if he did convey to Manachi in March 1995 that he no longer wished to be a director of Proplace, he not only made no effort to give effect to that decision, but he was prepared to exploit it to his benefit throughout his association with Proplace. It was only after Proplace had ceased to operate and when he was seeking approval to operate as an investment manager, that he chose to disassociate himself from any position of authority in Proplace.

SMITH'S PRESENT OCCUPATION

28. Smith has, since the collapse of Proplace, through a close corporation called Hamilton Smith and Associates CC, been conducting business as a financial advisor. He acknowledges that with hindsight, Proplace "turned out to be a very bad scheme". He claims, however, that at the time he did not believe there was anything wrong with Proplace. The recurring theme in his evidence is that he had no reason to believe there was anything wrong with the way in which Proplace conducted its business and that it never failed to meet its obligations to investors. He also relies heavily, as justification for his own participation in marketing the Proplace assured options investment schemes without advising potential clients of the risks involved (particularly where their "security" was a share in a block policy) on the fact that Proplace had a competent administrative staff whom he assumed would safeguard the interests of his clients.

29. When the Proplace crash came, Smith was undoubtedly upset for his clients. He even assisted one of his clients by paying him a sum of money out of his own pocket. Badenhorst confirms the remorse that Smith had when the Proplace debacle became known. Smith's remorse was for his clients' losses. He was sad that they had lost money. But we did not gain the impression that Smith has shown any remorse for the part he personally played in causing those losses. Throughout his evidence he attempted to justify what he had done. For example, although he knew that a block policy offered no security, he attempted to justify his having represented to clients that their interest in such a policy was their security by stating that they had the security of a contract with Proplace. He admitted that he took no steps to determine Proplace's ability to meet claims but attempted to justify his failure to do so, by stating that he had no

reason to believe that Proplace was not in a position to do so. When it was pointed out to him that when a client requested information with regard to the value of his policy the client was furnished, not with the surrender value obtained from the insurance company, but with a calculation made by the office staff, he said he had confidence in the administrative staff.

CHARACTER WITNESSES

30. Both witnesses called on behalf of the appellant, namely Badenhorst and Pearce, testified as to Smith's honesty and good character. Both are personal friends of his. Pearce is a non-executive director of the appellant. However,he has never been in a business relationship with Smith. Badenhorst was one of Smith's clients at Proplace who was fortunate enough not to have suffered a loss as a result of the Proplace crash. Badenhorst invested R200 000.00 with Proplace. This was to have been secured by a policy with Sanlam. The "security" turned out, according to Alberts, to have a value of only 50% of the investment. Badenhorst's dividend was thus only R99 572.00. However, because he had also invested in unit trusts, he was able to recoup his loss. The appellant annexed to the application a number of references from companies Smith has been dealing with since he left Proplace. These letters are addressed to the Financial Services Board. The branch manager of Sanlam Private investments at Tygervalley states that Hamilton Smith and Associates has been conducting business with Sanlam Private Investments since 1999, that the quality of their business

is "in good standing" and that he has no hesitation "in recommending that you grant them Terms of Business". Letters in identical terms were addressed to the Financial Services Board by a Broker Consultant and a Regional Broker Manager of Investec Investment Management Services, Sanlam Brokers Services : Westrand, and Momentum Distribution Services. Also annexed was a letter from Marriot Unit Trusts to the effect that Smith's CC had been conducting business with them since 1998 and that "the quality of their business with us is in good standing". It is not clear from these letters that the authors understood what it is that appellant has applied for. A more meaningful letter from Investec Asset Management dated 7 July 2003 was handed in at the hearing of the appeal. This letter states that Smith is a financial advisor accredited with Investec Personal Investments. It goes on to say that "Investec has interacted with Smith on a professional level for a number of years." He is a member of their Grayston Society. Members of that Society are their distinguished financial advisors, selected according to consistency of business and professionalism. The letter is signed by Renee Hart and James Towell. The former, according to Smith, is a broker consultant and the latter is her superior. The signatories of these letters all appear to be persons with whom, in their respective organisations, Smith CC placed business. They do not deal with the qualifications required of an investment manager. Those are qualifications which must be judged with reference to Smith's entire working career.

31. Appellant's counsel agreed that even if there were misgivings about Smith's involvement with Proplace, this Board should assess whether, to-day, Smith passes the test of good character and integrity. Counsel

submitted that Smith has, since leaving Proplace, developed as a person and has more insight than he had five years ago; that he has shown contrition; that he has learned from his experience and that he has continued his studies which has given him a greater insight into the relationship between a financial advisor and his client.

32. Smith did testify that he now realises that the Proplace scheme was a bad one, but throughout his evidence when dealing with his own participation, he did not acknowledge that he had done anything wrong. He is fact attempted to justify what he had done in the advancement of the scheme. As we have pointed out above, his remorse was for the fact that his clients' had lost money, not for anything he had done to cause that loss.

It is commendable that Smith has continued with his studies. In his favour we have taken into account the positive commendation he has received from both Pearce and Badenhorst. We have also had due regard to the fact that there is nothing to indicate that since leaving Proplace, Smith has been guilty of any conduct that demonstrates anything negative in his character.

33. As pointed out in paragraph 10 supra the whole picture must, however, be looked at. While involved with Proplace, Smith had a heavy responsibility towards his clients, particularly those who were not well versed in financial matters. In this he failed. He says he was duped by Manachi. Manachi might have succeeded in convincing him that Proplace was conducting a satisfactory business, but Manachi did not accompany him when he dealt with a client. It was when he was attempting to

persuade a client to invest in a Proplace scheme, that Smith's true character was put to the test. Nothing that Manachi might have told him could have led him to believe that in "selling" a Proplace assured option scheme, the client's interests were being looked after in the manner one would have expected of a prudent advisor.

34. In the light of the manner in which he conducted himself throughout his association with Proplace over a period of some three and a half years, as well as his efforts in his evidence to disclaim responsibility for the debacle suffered by his clients, it has not been established to our satisfaction on a balance of probabilities, that Smith has the necessary good character and integrity to be granted approval in terms of section 5 of the Act.

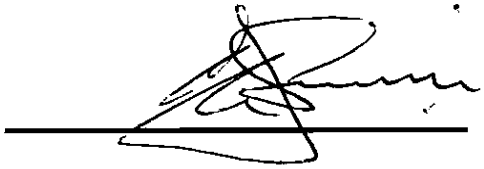
RESULT

35. For the reasons set out herein, the appeal is dismissed with costs.

DATED at CAPE TOWN this 15th day of SEPTEMBER 2003

G FRIEDMAN

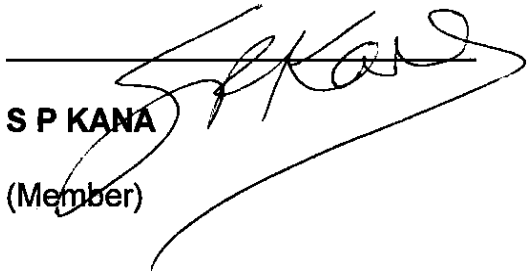
(Chairperson)



D K SMITH

(Member)

DATED at JOHANNESBURG this 6th day of SEPTEMBER 2003



S P KANA

(Member)