

HERMAN PRETORIUS: CLARITY ON THE FINANCIAL SERVICES BOARD'S INVESTIGATION

In the wake of the shooting by Mr Herman Pretorius ("Pretorius") in Cape Town, with indications of massive losses to investors that invested in his schemes, the Financial Services Board ("FSB") would like to offer some perspectives on the regulator's actions and investigations which it could legally have done and did do with respect to the business activities of the late Pretorius.

There have been varying concerns expressed and questions raised from the media and the industry, all of which the FSB understands to be ultimately focused on the likely losses to be suffered by investors arising from the activities of Pretorius and culminating in his death. To the extent that the questions have been raised and the concerns have been expressed in the interests of investors, the socio-economic effects of the losses to investors and the public interest, the FSB takes to heart all the concerns that have been expressed and the questions that have been raised. Accordingly, the FSB finds it necessary to actively engage on this issue to, among other things, explain how, in certain circumstances, investment relationships exclude the regulator's power. It is emphasized that the FSB's engagement and extent of disclosure in this regard is, as set out above, motivated by the need to do so in the public interest as envisaged in the provisions of Section 22 (1)(b) (iv) of the Financial Services Board Act of 1990 ("the FSB Act").

As a starting point, the manner in which members of the public may invest their savings may or may not, depending on the nature and structure of a particular investment vehicle, be subject to FSB regulation. For instance, the following types of investment vehicles would **NOT** be subject to FSB regulation:

- A partnership where individuals invest their monies in a partnership and utilise the capital to produce positive returns.

- An investment club where persons with a commonality of interest pool their monies to make an investment.
- A company formed for investment purposes in which investors obtain equity.
- A trust in which beneficiaries' monies would be pooled, but which would fall outside the ambit of the Collective Investment Schemes Control Act, due to the nature of the underlying investments or because it is a private arrangement between persons involved in a private business arrangement.

Certain investments may also not involve a “financial product” as contemplated by the Financial Advisory and Intermediary Services Act (FAIS Act). Becoming a member of an investment club or a beneficiary of a trust is not an acquisition of a financial product by the investor, even though the monies invested may be used by the investment vehicle to acquire a financial product, for example a share or derivative instrument (the latter being typically the types of products in which hedge funds invest).

Secondly, apart from having to scrutinise the type of investment vehicles which may be utilised to attract investors, it is also necessary to consider the manner in which investors are attracted. The ambit of the FAIS Act is focused on the rendering of financial services which typically involve three parties, namely a product supplier, an intermediary and a client. Unless a financial product is involved, the FAIS Act does not apply. Whilst product suppliers may be required to be authorised under the FAIS Act when giving advice relating to their products, the selling of such products by a product supplier directly to the public may not amount to an intermediary service, such as a company doing a private placement of equity.

It is against the above background that the activities of Mr Pretorius and the capacity of the regulator to intervene as well as the level of intervention from the regulator should be considered.

During May 2011 it was brought to the attention of the FSB that Pretorius was “*selling shares in unlisted companies*” and “*promoting these ventures*” by making representations to the community.

As the selling of unlisted shares may constitute a financial service as contemplated by the FAIS Act, the FSB followed up on the information which it subsequently received in order to establish whether or not Pretorius was acting in contravention of the FAIS Act, given also the fact that he was not licensed in terms of the FAIS Act.

Based on the information supplied in response at the time the FSB was satisfied that:

- The private equity or venture capital projects embarked upon or supported by Mr Pretorius did not constitute an activity which was subject to FSB regulation.
- Pretorius’s activities did not require a FAIS licence at the time.
- The manner in which Pretorius indicated that capital would be raised from investors and the investment vehicle used for the raising of such capital also did not point towards any activity which was subject to FSB regulation or otherwise unlawful, because:
 - Pretorius was acting as the principal (product supplier) and not as an intermediary when interacting with potential investors.
 - The investment vehicle as envisaged at the time, was a company. The FSB does not regulate the offering of shares in a company to the public. When such shares are offered, the company acts as a product supplier and must comply with the Companies Act.
- The explanations provided to the FSB concerning the nature of the trusts as investment vehicles were such that it could not be established with certainty that their activities were subject to FSB regulation. Some of the ventures were designed

for individuals who could properly be considered to be involved in a private domestic affair.

Following further complaints received by the FSB in May/June 2012 against Mr Pretorius it was decided that a formal inspection should be conducted on his affairs of Pretorius and the various investment vehicles utilised in order to establish whether or not the activities of the investment vehicles were subject to FSB regulation. The inspection was underway at the time when Pretorius allegedly committed suicide.

Questions have been raised about the speed at which the FSB reacted to these allegations and complaints, with some suggesting that the regulator should have acted sooner. There are media reports indicating that concerns were raised with the FSB more than 8 years ago regarding Pretorius' involvement in hedge funds. In this regard, the FSB wishes to clarify that at that time that these concerns were raised the regulator could not establish any evidence of Pretorius' activities in hedge funds or any irregularities with regard to the issues that were raised at the time. Further, the FSB wishes to categorically state that, as detailed above, appropriate action was taken from the time that the allegations first surfaced, and that the investigation into this matter is on-going.

Concerns have also been raised about how the FSB *“allowed what amounts to a gigantic Ponzi scheme to continue under its nose.”* Once again, it must be remembered that schemes that are operated outside of and actively in secret from the regulator cannot be said to be operating ***under the regulator's nose***. Accordingly, to the extent that there was a Ponzi scheme in Pretorius' activities, such a scheme would have been operated in strict secrecy from the FSB.

The FSB is of the view that if there was any non-compliance by Pretorius, it was well-designed not to be subject to regulatory scrutiny. To the extent that investors were lured into any of his projects, such investors carried the risk and obligation to enquire into the merits before parting with their money, especially where above-average returns were being offered. The loss of so much money to so many investors is a sad state of affairs but one for which the regulator is not accountable.

It has in the meantime come to the FSB's attention that the RVAF Trust was placed under provisional sequestration on 2 August 2012 by the Western Cape High Court. The Regulator supports this action and encourages investors to take the necessary legal action to attempt to recover their monies, especially to the extent that the investments were made via schemes falling outside of the regulatory net. As the investigation into this matter unfolds the FSB will, in so far as matters fall under its jurisdiction and mandate, urgently take appropriate action.

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