PART TWO

The period 1991 to 1997

1 In July 1991 Wingate Holdings Ltd applied to the Registrar of Banks ("Registrar") for a banking license. Wingate Holdings Ltd was the holding company of Wingate Finance Ltd, which was to change its name to Wingate Bank Ltd, if the application were successful. The application was refused on a number of grounds, one of which was that Wingate Finance Ltd was conducting the business of a bank at the time; the application for a banking license was to regulate its illegal activities rather than due to a genuine desire to render banking services. The Registrar directed that the business of Wingate Finance Ltd was to be wound down. The person who acted on behalf of Wingate Holdings Ltd was Levenstein. Two further applications were unsuccessful.

2 On 12 July 1995 Rand Treasury Ltd ("RTL") was incorporated. The shareholders included Levenstein, Buch, Diesel, Krowitz, Brian Levenstein and Lurie. The directors were Levenstein, Buch, Diesel, Krowitz, Lurie and Lopes. On 19 July 1995, at the first meeting of the board of directors, Levenstein was appointed chairman and Diesel managing director. At the second meeting of the board on 17 August 1995, Peter Springett was appointed as director and chairman,

Levenstein became deputy chairman and Krowitz chief executive officer. On 2 October 1995 the directors agreed that consideration should be given to an application for a banking license. The bank's services would be offered to "a niche market of professionals and select high net worth individuals". Slender was appointed to the board. On 24 January 1996 Schneider was appointed to the board and Kaminer was appointed his alternate. On 20 March 1996 it was minuted at a board meeting that the application for a banking license was in preparation. On 1 March 1996 the Rand Treasury Shareholders Trust ("Shareholders Trust") was created. The Shareholders Trust was used to buy (and sell) Holdings shares purportedly with the intention of moving shares from "weak hands" to "strong hands", but in reality to support the Holdings share price.

3 RTL applied to establish a bank on 15 April 1996. The application deserves scrutiny in view of what transpired during the bank's short life. The application referred extensively to a book written and edited by Levenstein and Krowitz, "Futures and Hedging Demystified" ("the book").

- In the introduction to the application it was stated: "RTL has been designed and resourced to match and satisfy non-fractionalised private banking requirements. A private bank may not entertain banking activities beyond the fixed framework of its call services and image profile. … In addition to a powerful mix of skills and expertise, an authentic private banking concern must be driven by a strict and yet sophisticated risk management environment. The development of a particularly disciplined culture functions as the platform for the regulation and control of a risk management infrastructure, carefully managed to accommodate consistent standard of excellence."

- In the section of the application dealing with "liquidity risk", this quotation from the book appears: "… The liquidity management of a bank is ultimately and inextricably linked to its financial image profile in the marketplace. Banking culture and the ability of the board and management to preserve and grow the income statement in compliance with sound and well defined strategic boundaries, is the critical success factor which determines the effectiveness of liquidity management …".
- The opening paragraph of the section on "solvency risk" included this passage: "The strategic and operational call of the original Wingate team has been further strengthened by a carefully selected mix of risk management, banking and treasury skills. Commitment to risk management, risk avoidance and the satisfaction of shareholder expectations has functioned as the culture binding ingredient for the team building process. … The private banking objectives of RTL and accordingly the projected structure of both its balance sheet and income statement are specifically designed to dramatically minimise generally accepted capital or solvency risk requirements."
- Having stated under "credit risk" that "RTL will employ generally accepted banking practice for the application of credit risk [and that] traditional norms and practice will be merged with a specific culture

that it is intensely committed to risk avoidance", the book is quoted at some length. Two sentences strike one as particularly prescient: "Large exposure transactions are often driven by Ego and incentives. Indeed the Ego factor is endemic to the banking industry, and has the potential to shape disaster." The application stated that a credit committee approved and mandated by the board would have the necessary authority to approve advances in compliance and in conformity with a risk management policy framework.

- In dealing with "pricing risk" the application stated that "RTL's policy has a conservative and controlled approach over the pricing between assets and liabilities … A diverse mix of quality income streams from merchant banking, corporate finance, financial services and allied activities also forms the basis of risk management architecture to further cushion any unforeseen rate movements."

4 The qualifications of the directors who would play a prominent part in the affairs of the bank were described in the curricula vitae which formed part of the application:-

- Peter Springett ("Peter") was 65 years old. From 1956 until 1989 he had been employed by Barclays Bank, later renamed First National Bank ("FNB"). He had worked his way up through FNB from manager's assistant to executive director on the main board of the FNB group of companies. From 1990 to 1994 he was non-executive chairman of the Wingate Group.

- Levenstein was 45 years old. He was a chartered accountant who had been associated with a family firm of accountants, Levenstein & Partners, from 1977 until 1995. He was the deputy chairman of the Wingate Group from 1987 to 1994. He served on the board of Mercantile Bank Holdings Ltd in 1993-4.
- Krowitz was 33 years old. His qualifications were B Com Honours MBA. He had worked in different capacities for different employers such as Macsteel International (Pty) Ltd, Volkskas Merchant Bank Ltd and Santam Bank Ltd.
- Lopes was 40 years old. His academic qualifications were exaggerated. He had worked, *inter alia*, for National Discount House of SA Ltd and Mercantile Bank Ltd.
- Diesel was 34 years old. His main working experience had been obtained working in the treasury of Nedcor from 1989 to 1994.
- Lurie was 54 years old. He was a chartered secretary for 25 years and had been a promoter and founding shareholder of Wingate Holdings Ltd.
- Schneider was 50 years old. He was a chartered accountant practising as the senior partner of Schneider Katz Chartered Accountants.
- Slender was 67 years old. He worked for different businesses over the years to become managing director of Flexi Trainer Industrial (Pty) Ltd between 1987 and 1993.

- <u>Buch</u> was 44 years old. He was a chartered accountant and senior partner of Levenstein & Partners. He was a promoter and founding shareholder of the Wingate Group.

5 As at 10 July 1996, RTL had a share capital of R39.3m, debenture capital of R25m and revenue reserves of R1.3m. It was anticipated that RTL would have income of R6.8m for the first year. The anticipated expenditure was R2.9m.

6 On 20 August 1996 the application for authorisation to establish a bank in terms of <u>s12</u> of the Banks Act, 94 of 1990 ("Banks Act") was granted. The Registrar took the view:

- that the application had been well considered by the applicants;
- the application bore evidence of a conservative, prudent approach to banking;
- the board of directors were people with experience and qualifications well above the average board member of other banks;
- the board members were not the same as those rejected in 1991, although some of them, including Levenstein, were the same.

7 RTL resolved on 16 September 1996 to change its name to Regal Treasury Private Bank Ltd ("Regal Bank" or "the bank"). On 2 January

1997 a certificate to conduct the business of a bank was issued in the name of Regal Bank.

8 Lubner and Mark Springett, the son of Peter, attended their first board meeting on 23 October 1996.

9 On 22 January 1997 Birrell and J Pollack became directors of the bank. It was minuted that share capital was expected to reach R56m by 28 February 1998. Anticipated net income for the financial year was R5m. The board of directors met once a month. On 1 March 1997 the bank moved from the premises that it had occupied in Rosebank to its own building, Stone Manor, in Sandton. Board members were requested to encourage "suitable friends and … present shareholders to participate in the bank's core business". As at 31 August 1997, the income of the bank was R5m and expenses R2.3m. Share capital was R55m. On 31 October 1997 it was minuted at a board meeting that interest income in excess of R1m for the month and revenue reserves of more than R10m had been reached. Assets under management were R40m. Davis was appointed chief financial officer ("CFO") with effect from 1 November 1997. He was a chartered accountant who had been employed at one time by Levenstein & Partners.

10 During the last six months of 1997 signs of conflict between Peter, the chairman, and Levenstein, the chief executive officer ("CEO"), were

recorded in the board minutes. At the meeting of 24 July 1997 it was minuted that: "6.5 CEO responsible for day-to-day running of the Bank. Lines of authority and mandate parameters between CEO and chairman now clearly defined. Relationship between CEO and chairman to evolve in compliance with standard industry norms.

6.7 Executive directors have a fiduciary duty in terms of the Banks Act and Companies Act and should speak with one voice." On 21 August 1997 it was minuted that negotiations were in progress to acquire a stockbroking firm. Peter Springett requested that the bank proceed with caution in the negotiations and that a final decision should not be made until a full feasibility study had been carried out. The issue of "stockbroking activity" was discussed at the board on 25 September 1997. It was agreed that a full feasibility study would be undertaken before any contracts were signed. Peter Springett tabled fourteen duties of the chairman of the board as required by the King report. It was further reported that the King report recommended that: "the board must retain full and effective control over the corporation, monitor the effective management and ensure that decisions on material matters are in the hands of the board." On 8 October 1997 Levenstein called a special meeting of the board to discuss his differences with Peter Springett and their apparent incompatibility. He launched a personal attack on Springett accusing him of anti-Semitic behaviour and of using "horrific divide and rule" tactics. The majority of the directors decided that Springett should resign immediately. He was given time, however, to resign with his “profile intact”. At a board meeting on 30 October 1997 it was recorded Peter Springett supported the stockbroking initiative.

11 The financial results for 1 March 1997 to 27 February 1998 reflected a growth in share capital from R51.6m to R54.6m. Profit after tax had grown from R4.3m to R8.3m. Deposits were over R100m. There were about 500 shareholders. The annual report described the nature of the business in these terms:

> “Regal Treasury Private Bank Ltd caters for the banking requirements of well to do individuals who seek professional expertise coupled with a high standard of personal service. … We consider ourselves to be the trustees in South Africa of the traditional values of integrity, service and discretion developed over centuries by the classical European private banks. … The risk profile of the bank is conservative by nature and design.”

<u>1998</u>

12 The seeds of the demise of Regal Bank were sown early in 1998 when Peter resigned as chairman and Levenstein became acting chairman and later chairman of the board, while remaining on as CEO. The reasons for Peter Springett’s resignation were various. Diesel spoke of a power struggle. Levenstein informed the bank supervision division (“BSD”) of the South African Reserve Bank (“Reserve Bank”) that there

was constant disagreement on strategic issues. The evidence of Peter was that Levenstein wanted to run the bank as a one man bank and that the majority of the board supported Levenstein. In Peter's words, it was a "classic case" of a lack of corporate governance leading to problems.

13 The departure of Peter was significant for a number of reasons. Peter was the one director who was an experienced banker. No one with his experience thereafter remained on the board. The executive directors had varying degrees of specialist expertise but none of them had served at a senior level in a reputable bank, as Peter had done. The bank lost an independent chairman who understood and applied sound corporate governance principles. Had Peter been replaced by someone with similar attributes, the path the bank took may have led in a different direction. Instead, Levenstein became chairman, a man with limited experience in banking and a contempt for corporate governance. The exposure Levenstein had had to banking had been his involvement with Wingate, which was <u>not</u> granted a banking license, and for a limited period with Mercantile Bank.

14 At the first meeting between Levenstein and the BSD on 18 February 1998 after he had become acting chairman, Martin, a deputy general manager of BSD, expressed his disapproval of Levenstein occupying the positions of both acting chairman and CEO. Levenstein said he

would be acting chairman "for the short term". On 24 February 1998 Martin followed up with a letter sent to Levenstein in which the opinion was expressed that Regal Bank "would not be exercising sound corporate governance if a non-executive chairman was not appointed to the board" of the bank. The Reserve Bank's objection was not discussed at a board meeting until 28 May 1998, when the board decided that "due to the current operating and financial success achieved with the CEO as acting chairman, the *status quo* should remain". On 30 September 1998 the Registrar of Banks ("the Registrar") addressed a letter to Levenstein in which he gave the bank until 31 December 1998 to appoint a suitable non-executive chairman. At a meeting of the board on 22 October 1998, the Registrar's letter was not tabled. The board instead agreed to appoint Levenstein as chairman. Lubner voiced reservations. Levenstein replied in a lengthy letter dated 29 October 1998 to the Registrar's letter of 30 September 1998. The letter spoke of the need for the fusion of the roles of CEO and chairman; that the appointment of an independent chairman could lead to "a wedge being driven between operational and strategic balance" which could "impair harmony and ultimately risk management focus". The bank's position was summarised in this passage: "In summary we strongly believe that having regard to Regal's historical development and its current operational focus and strategies, an 'enforced' separation of the roles of chairman and CEO at this juncture would, instead of enhancing shareholder protection, create sufficient operational and governance difficulties to in fact prejudice shareholders." A few days later an application by Regal Treasury Bank Holdings Ltd ("Regal Holdings" or "Holdings") to register as a holding company was signed by Levenstein as chairman. On 17 November 1998 the Registrar informed Levenstein that he could remain on as chairman until Regal Holdings had been listed. At a board meeting on 26 November 1998, Lubner "tabled the sensitivities and complexities regulating the future dissection of the chairmanship and CEO roles." The board nevertheless decided that the *status quo* should remain.

15 During the course of the year, Worldwide Africa Investment Holdings Ltd ("Worldwide") and Regal Bank negotiated the acquisition of shares in Regal Bank by Worldwide. On 6 July 1998 an agreement was concluded. On the following day the bank applied to the Reserve Bank to allot 20% of the total issued shares to Worldwide. The application was granted. Two Worldwide representatives were appointed to the board of the bank, Nhleko and Chanesta. They attended their first board meeting on 22 October 1998. The Reserve Bank informed the bank on 15 December 1998 that an application by Worldwide to acquire more than 15% of the shares in Regal Holdings would have to be made to the Reserve Bank.

16 The activities of the bank expanded. A stockbroking division became operational on 2 March 1998. The assets under management reached R100m in April 1998, R120m in May 1998 and R130m in July 1998.

Two new directors, Radus and Kaminer, joined the boards of Holdings and the bank. Radus (59 years old) had been an attorney in a small private practice in Johannesburg for many years. Kaminer (75 years old) was a mechanical engineer who had been involved with various businesses over the years. He had not been a director of a bank. Birrell resigned as director in September 1998. At the third annual general meeting of the members on 23 July 1998 the authorised share capital was doubled from 100 000 to 200 000 ordinary shares. February 1999 was confirmed as the date for listing of Regal Holdings. On 5 November 1998 the Reserve Bank informed Regal Bank that non-banking business was to be structured under a controlling company as opposed to under a bank and that it did not object to the registration of Regal Holdings as the controlling company. Regal Holdings was incorporated on 27 November 1998. During the course of the year a unit trust management company was formed.

17 The financial results of Regal Holdings for the period 1 March 1998 to 28 February 1999 showed an increase from 1998 to 1999:

- in share capital from R54.6m to R335.1m;
- in profit after tax from R8.3m to R36.7m;
- in earnings per share (cents) from 19.4 to 48.1.

An analysis of "annuity" income revealed:

Asset management	18%
Corporate finance	15%

Information technology	13%
Stockbroking	36%
Structured finance	18%
	100%

1999

18 At the commencement of the year the board of directors of Regal Holdings consisted of six executive directors and eight non-executive directors. The executive directors were Levenstein (CEO and executive chairman), Diesel, Krowitz, Lopes, Mark Springett and Radus. The non-executive directors were Buch, Kaminer, Lubner, Lurie, Nhleko, J Pollack, Schneider and Slender.

19 On 17 November 1998 the Registrar had given the bank until the listing of Regal Holdings to appoint a non-executive chairman. Regal Holdings was listed on 25 February 1999. Levenstein nevertheless remained on as chairman. At a meeting between the BSD and Levenstein on 29 March 1998, Levenstein said that a proper candidate was not available and the solution would not be easy. Three possible candidates were named: Joffe of Bidwest, Lubner and J Pollack. Martin requested action to be taken before July 1999. On 20 April 1999 Martin wrote a letter to Levenstein in which he confirmed the telephone conversation of that day in which he had told Levenstein "that this office feel strongly that the

roles of chairman and chief executive officer should not vest in the same person." The Registrar wrote a letter to Levenstein to similar effect on 10 May 1999, expressing the belief that Levenstein's reasons for not separating the roles "are insufficient to override sound corporate governance principles, with which this offices believes banks should comply." Levenstein was told that the matter should be finalised by 31 July 1999. At a meeting of the boards of directors of Regal Holdings and Regal Bank on 23 June 1999 it was minuted that "discussions with the Reserve Bank on the splitting of the roles of chief executive officer and chairman continue". On 19 July 1999, Levenstein wrote a letter to the Registrar in which he stated that a number of factors made it extremely difficult and impractical to appoint a non-executive chairman by 31 July 1999. The factors listed by Levenstein included ongoing negotiations with certain institutions regarding potential investment in Regal; that the appointment of an independent chairman "could prove disastrous to the harmonious (and effective) prevailing leadership structures"; and that the "aftershock of a prior abortive attempt to foist a hierarchical executive structure upon Regal at an inappropriate time is still keenly felt within the Regal corridors". The Registrar responded on 28 July 1999 by giving the bank until 30 September 1999 to separate the roles. At a combined meeting of the boards of Holdings and the bank on 29 September 1999 Levenstein relinquished his position as chairman and Lurie was appointed as chairman.

20 In the face of opposition from the Reserve Bank, Levenstein was executive chairman and CEO for a nineteen month period, with the support of the majority of the board. From inception, the Reserve Bank had voiced its disapproval and placed the bank on terms to appoint a non-executive chairman. The issue was discussed at meetings between the BSD and the bank, letters were exchanged and extensions were given to comply, the final one expiring on 30 September 1999. Levenstein played with the BSD: at first he said that his appointment as acting chairman was for a short term; then he justified the failure to accede to the Reserve Bank's request on various grounds including that a wedge should not be "driven between operational and strategic balance"; later the excuse was that a suitable candidate could not be found. And ultimately, in an act of cynicism, Lurie was appointed as chairman. Lurie had never been mentioned as a potential candidate; he had been on the board all along; he had been associated with Levenstein in Wingate and in the formation of Regal Bank; Lurie had no experience of running a large corporation or a bank; and he was Levenstein's brother-in-law. Lurie was to remain chairman until March 2001, a period of eighteen months.

21 During 1999 and 2000 Regal Bank's internal audit function was poor. A meeting was held on 18 January 1999 between the BSD and the bank. The bank was represented by Davis, the CFO, and Hiralal. The BSD was represented by Nolte and Ms Pretorius. Hiralal had previously

been employed by Levenstein & Partners. He was appointed as the new internal auditor of the bank. BSD pointed out that the bank's growth required more staff to perform the internal audit function. The BSD followed up with a letter expressing the same view on 26 January 1999. Two years later, the internal audit function of the bank was still poor and the bank appointed Price Waterhouse Coopers ("PWC") as internal auditors. Strydom of Ernest & Young ("EY") testified that EY did not rely on the procedures performed by the bank's internal audit department. EY did not regard them as an independent internal audit department. In Strydom's view very little time was spent on internal auditing.

22 In the first half of the year, two events of note occurred:-

- The first was the listing of Regal Holdings on 25 February 1999. At a joint meeting of Holdings and the bank on 24 March 1999, it was recorded that "The share price is presently below the aspirations of the financial community. Nevertheless, the fundamentals in respect of a stronger share price remain in place." Mark Springett gave insight in his evidence into the pressures on the share price from the very beginning. He said that Levenstein refused to offer any shares to institutions prior to listing; he insisted on listing Holdings by way of introduction. The bank used its own stockbroking firm, instead of an independent stockbroker, as a sponsoring broker. Prior to listing, a sweepstake was held at the bank. Staff had to predict the Holdings share price on listing. The lowest price predicted was R7.80 and the highest about R50. Levenstein's prediction was between R30 to R40. When the shares listed, the price was R7.50, i.e. well below the expectations of the bank's employees and management. Inan apparent attempt to boost the Holdings share price, the Shareholders Trust was used to buy Regal Holdings shares from the time of listing. At a trustees' meeting on 24 March 1999 it was noted that "the share price subsequent to listing indicates that the equity base requires strengthening". Shares were bought by the trust to "channel shares into stronger hands". On 28 June Levenstein sent a note to Krowitz and Radus expressing his concern about Mark Springett's involvement with "front running", which had an influence, presumably negative, on the price of Holdings shares.

- The second was the conclusion of the first Mettle Ltd ("Mettle") transactions. On 10 February 1999 four contracts, making up the Tradequick structure, and on 18 March 1999 two contracts, making up the RVM structure, were concluded. The essence of the two structures was "back to back" preference share structures. In both instances the bank invested in preference shares in Mettle special purpose vehicles ("SPV's") and the SPV's deposited similar or lesser amounts with Regal Bank. The Tradequick and RVM structures were tax driven. The potential tax benefit was that the accrued preference share income would not be taxable and the accrued interest on the loan would be tax deductible.

23 During July 1999 and thereafter a series of events occurred which demonstrated that:

- the concept of corporate governance was foreign to Levenstein and the directors of Regal Holdings and Regal Bank;
- Levenstein was unfit to be chairman or CEO of a bank;
- the directors, including the non-executive directors, failed to act in accordance with their statutory duties and the recommendations of the King Report.

24 It all began to go wrong on 6 July 1999. Levenstein gave an instruction to the asset management division. There is a dispute of fact on the content of the instruction. On the one hand, there are the versions of Levenstein, Radus and Krowitz. Levenstein's version before the commission was that his instruction was to stop "front running" which he described as "using Regal shares inappropriately … This process where Regal shares will be pushed down artificially". The evidence of Radus was that Levenstein's instruction was "to try and avoid selling Regal shares through Regal Treasury Securities because it looked bad that we were selling our shares". Krowitz testified that Levenstein said: "I do not want the stockbrokers – the Regal Treasury stockbrokers – to sell Regal shares. Sell your shares, use somebody else." On the other hand, there is the evidence of Mark Springett ("Mark"), Kruger and Newman, directors of the asset management company. Mark's evidence was that

he was told by Bacher that he had received an instruction from Krowitz and Levenstein that "asset management was no longer allowed to sell any shares in Regal [Holdings] on behalf of any of its clients". While Bacher was telling Mark about that instruction, Levenstein walked into Mark's office and repeated the instruction. He left and returned later to tell Kruger to investigate the ramifications of advising a client that a client's instructions to sell Holdings shares would not be carried out. Levenstein repeated the instruction at an investment committee meeting later that day. Mark's evidence was corroborated by Kruger and Newman.

25 The probabilities favour the version of Mark, Kruger and Newman:-

- Mark and Kruger acted consistently with their version. They consulted Peter, Mark's father, and sought his advice; they consulted an attorney; they followed the attorney's advice to write a letter recording Levenstein's instruction and Mark's concerns and conveying those concerns to Levenstein. Mark drafted a contemporaneous letter dated 14 July 1999 which gives a detailed account of what transpired on 6 July 1999. Mark also raised the issue of the dual roles occupied by Levenstein. He handed Levenstein the letter.
- When Mark confronted Levenstein, Levenstein's response was not to deny the allegations there and then and to clear up what might have been a misunderstanding. Instead his response was an

aggressive one: he accused Mark of a breach of his fiduciary duties and immediately announced that he was removing Mark as CEO of the asset management division and as managing director of the unit trust management company.

- Levenstein's written response, in a letter of 14 July 1999 drafted by an attorney, was to deny Mark's version only in the baldest of terms. He did not on that day or subsequently dispute Mark's exposition of the facts or place his version on record.
- In his resignation letter of 26 July 1999, Kruger set out the same version. Again there was no response by Levenstein.
- Mark, Kruger and Newman were credible and convincing witnesses. Levenstein was not. As will be shown later, Levenstein is a liar. He lied to his fellow directors, he lied to the Reserve Bank, and he lied to the commission. Levenstein's version of the dismissal of Mark was not corroborated by Radus. Radus was a particularly poor witness. In regard to where the instruction was given he said: "I could have been sitting at Jeff's desk. I could have been sitting in Mark's office. I could have been sitting in Carl Kruger's office. … You know, it might have been just outside my office." Later he said the instruction was given in Levenstein's office. On Mark's version, the instruction was given in his office and then in the meeting room where the investment committee met.

- Mark's version is consistent with Levenstein's obsession with what he regarded as a low Holdings share price and his subsequent conduct in discouraging employees from selling their shares.

26 I find that on a balance of probabilities on 6 July 1999 Levenstein gave an unlawful instruction to the asset management division not to sell any Regal Holdings shares on behalf of its clients. That is strike one.

27 Levenstein summarily dismissed Mark late on 14 July 1999 without giving him a hearing. That is strike two.

28 In the dismissal letter of 14 July 1999 Levenstein accused Mark of breach of fiduciary duty and grossly insubordinate behaviour. There was no substance to those allegations. Mark was quite entitled to resist the unlawful instruction and to raise his concern about Levenstein not giving up the chairmanship. That is strike three.

29 After he had dismissed Mark, Levenstein accused Mark of more serious misconduct, namely, theft of between R5m and R10m, fraud and theft of client's money. When those allegations were initially made, he had no proof thereof at all. He relied on what Krowitz had told him, which was that "an asset management account can never run into debit". Krowitz was an uninformed layman. Some proof was later obtained, on 28 April 2000, when EY produced a draft report in support

of Levenstein's accusations. The EY report was convincingly and in fine detail disputed by Mark, who did know what he was talking about, and a forensic auditor whom he consulted. The charges were never proved and the allegations were subsequently abandoned. That is strike four.

30 Levenstein did not rest with merely making allegations against Mark. He instituted civil proceedings against Mark, Kruger and Newman for return of their Regal Holdings shares. The litigation in the High Court was converted into an arbitration. The arbitration was subsequently settled on the basis that Mark and Kruger could retain their shares or the proceeds. When she was sued, Newman returned her shares to avoid the costs of a legal battle. That is strike five.

31 Criminal charges were laid against Mark, first at the office of Serious Economic Offences and when that office declined to entertain the charges, at the South African Police Services ("SAPS"). Nothing came of the criminal prosecution. That is strike six.

32 The civil litigation cost the bank R806 945.69. That is strike seven.

33 On the day after Mark was dismissed, attorneys Werksmans, acting for Regal Bank, sent a letter of demand to Peter in which it was claimed that during the period of his chairmanship, which had ended eighteen

months before, he had caused to be issued to himself 925 000 shares without the authority of or disclosure to the board. On 16 July 1999, attorney Michael Krawitz, acting on behalf of Peter, pointed out that the shares had been issued with the knowledge of the board of directors, that share certificates were signed by duly authorised officials of the bank, and that the shares had been issued in tranches over a period of two years. Levenstein conceded in evidence that those allegations were factually correct. Nevertheless, civil litigation was instituted by the bank against Peter. This litigation was later consolidated with the arbitration against Mark and Kruger, and eventually settled on the basis that Peter could retain the proceeds of the shares that he had sold. Peter was therefore was completely vindicated. But by then he had spent approximately R500 000 in legal costs. The litigation against Peter was actuated purely by malice. He was sued because he was Mark's father to put pressure on Mark not because there was any substance to the claim against him. That is strike eight.

34 Levenstein must have obtained advice from the bank's attorneys that, in terms of the articles of association, in order to remove Mark as a director he needed a round robin resolution signed by all the directors. Such advice would have been in keeping with the articles of association of Regal Holdings. Two of the non-executive directors were Schneider, a chartered accountant of long standing, and Lubner, a well known and experienced businessman. When they were asked to sign a

round robin resolution, they refused on the basis that they wished to have Mark's dismissal debated at a board meeting. That was also Mark's wish. Levenstein refused. The only way Levenstein could comply with the articles of association was to force Schneider and Lubner off the board. Schneider resigned after he had been told to resign "with dignity", failing which he would be accused of being in breach of his fiduciary duties. There is a dispute of fact between Lubner and Radus and Krowitz. The latter two testified that Lubner indicated telephonically that he would resign. Lubner denied that he had resigned and at that time recorded his denial in at least two letters which he wrote to Levenstein. It is common cause that Lubner attempted to attend a board meeting on 28 July 1999,, at which the BSD was to be present, and that Levenstein refused to allow him to attend. Krowitz's description of what transpired between Levenstein and Lubner at the bank's premises on that occasion was that Levenstein "effectively denigrated Bertie Lubner, took his dignity, attacked him. It was disgraceful." Lubner thereafter played no further part in the affairs of Holdings or the bank and by his conduct resigned as director. Lubner and Schneider were removed. Levenstein had got his way. That is strike nine.

35 Despite nine strikes, Levenstein was not out. The board did not remove him as CEO and chairman. He remained chief executive officer and chairman, with no one left who was willing to stand up to him. The only

reason he resigned as chairman at the end of September 1999 was because the Reserve Bank had insisted he do so. Having rid the board of the two directors who showed their independence, he could remove Mark from the board with impunity without a board meeting. A round-robin resolution was circulated and signed by all the remaining directors in early August 1999, to their shame.

36 The signatories to the resolution were questioned at the commission about their role in that sorry saga.

- Nhleko, a non-executive director representing the major shareholder, testified that his view was that the issue should have been dealt with by the board. He was briefed by Levenstein and Krowitz and having heard their version of the allegations against Mark, went along with the CEO and the majority of the directors, who had signed the resolution before he did. At the time he signed, he did not know that Schneider and Lubner had resigned.
- Lurie was not told about Mark's allegations against Levenstein at the time; he accepted Levenstein's version; he could not recall that Mark had called for a special board meeting on 11 August 1999 or that Schneider and Lubner had supported Mark's call for the matter to be debated at a board meeting.
- Diesel signed the round-robin resolution on the information presented to him by Levenstein; he was not aware that Schneider

and Lubner had refused to sign the resolution and had demanded that the matter be discussed at a board meeting;

- Buch agreed “with hindsight” that Mark’s dismissal should have been discussed at a board meeting; he accepted Levenstein’s version that Mark had been involved in “some fraudulent activities”; he knew that Mark had called for a board meeting but he did not know that Schneider and Lubner had done so;
- Krowitz was not aware at the time that Schneider and Lubner had refused to sign the round-robin resolution and had insisted on a board meeting;
- J Pollack could not remember the dismissal of Mark;
- Kaminer, on his return from a game reserve, signed the resolution on the basis of what Radus and Krowitz told him and he said he saw the evidence the bank had against Mark.

37 The overwhelming impression one has after hearing all the evidence is that the directors spent as much time reflecting on the matter as they do when they decide whether to order Ceylon tea or Rooibos tea.

38 It was vital that the matter be discussed at a board meeting so that Mark’s allegations against Levenstein and his denial of Levenstein’s allegations against him could be ventilated. The directors would then have acted with knowledge of the relevant facts. Had all the facts been debated, the board should have come to the conclusion that Levenstein

had given an unlawful instruction and that he had dismissed Mark for no good reason and without following fair procedure. Levenstein would have had had to go; Mark, Lubner and Schneider would have remained on. (One suspects, however, that the majority of the board would have supported Levenstein, come what may.) Instead, it was only at this commission that the issues were properly ventilated, more than two years later too late for the depositors and shareholders.

39 After the dismissal and resignations, a joint board meeting was held on 18 August 1999. The "effective removal" of Lubner and Schneider was "confirmed and ratified". After that meeting, the directors could not have been under any illusions that Lubner and Schneider had resigned voluntarily. On 7 September 1999, Levenstein met with the BSD. Levenstein told the BSD that there "was strong adherence to corporate governance in Regal". Martin expressed the opinion that there might be a market perception that certain members of the board were removed because they did not accept how Mark had been dismissed. On 12 October 1999 Levenstein wrote a letter to the Registrar. He referred to the meeting of 7 September 1999 at which he had taken the opportunity, in his words, "to communicate a balanced risk management and corporate governance perspective regarding recent dismissals and "resignations" from our board." On 22 October 1999 he wrote a letter to the Registrar complaining about the conduct of Barrow of the Financial Services Board ("FSB"). He said that Regal would

pursue the prosecution of Mark with serious intent. In a letter of 4 November 1999, in referring to "Lubner and Springett", he wrote: "Risk management comes first. Corporate Governance requires strength, courage and an iron resolve." As Levenstein was to demonstrate time and again, he confused corporate governance with thuggery.

40 On 21 September 1999 the Holdings results for the six months ended 31 August 1999 were published:-

- Publication took place without the auditors having any input and, of more significance, without the approval of the audit committee. The first time the audit committee saw the results was on publication. The first time the audit committee debated the results was at a meeting held on 29 September 1999, a week after publication. One of the more amusing entries in a minute that one can wish to see is this one: "The audit committee agreed that the proof of the interim results should be scrutinised by the audit committee before publication."
- Three entries in those results merit discussion:-

	31/8/99	28/2/99
Income before taxation	R40.2m	R50.2m
Debenture capital	R30m	R30m
Deposits	R424.6m	R295m

  - o The interim results foreshadowed a spectacular growth in income before taxation if R40.2m was earned in six months compared to R50.2m for the whole previous year. But included in the R40.2m was R21m of branding income. At year-end only R5.5m of branding income for the whole year was recognised and the total profit before taxation was only R55.5m.

- At year-end, EY required the whole amount of R30m debenture capital to be set off and nil debenture capital was shown.
- Deposits showed an impressive increase from R295m as at 28 February 1999 to R424.6m six months later. Included in the latter amount, however, were the Tradequick R100m and RVM R50m amounts, which were not true deposits. Deduct those amounts from the sum of R424.6m and one is left with deposits of R274.6m, a decrease in deposits of R20.4m.

41 At the last joint meeting of the boards on 24 November 1999, under "Strategy", this was minuted: "Branding will provide significant revenue streams in future. Regal's backing, together with its banking infrastructure has served as a powerful draw card for ventures looking to expand and improve their profiles. The acquisition of equity stakes as consideration will give Regal an ongoing interest in the growth of such ventures. The strategy is unique and it is vital to protect it from the attention of the likes of Investec."

2000

42 The year 2000 began with another test for the directors, which, led by Lurie, they failed dismally.

43 On 29 December 1999 Levenstein wrote a letter to the directors of Holdings and the bank and submitted "that my efforts for Regal from inception to date justifies a cash bonus of R2m and a structural redesign of my restraint share allocation". He requested a further restraint allocation of 5m shares. On page 2 of the letter appears the signatures of Lurie and Buch and the following manuscript note in Lurie's handwriting: "The non-executive directors of Regal have unreservedly and unconditionally authorised and approved the contents of this letter relating to cash and the 5m shares requested by the chief executive officer – Mr Jeffrey Levenstein". On 14 February 2000 Holdings, the bank and Levenstein signed an agreement in terms of which Holdings and the bank agreed to pay Levenstein R2m and to issue 5m shares on or before 31 March 2000 as a restraint of trade payment. On 2 March 2000 a further agreement was concluded in terms of which, inter alia, Levenstein became entitled to receive dividends before the issue of the 5m shares.

44 Levenstein was paid the R2m on 15 February 2000. The 5m shares, which were worth about R36.5m at the time of the agreement, were

never issued. Levenstein was paid R650 000 during 2000 as "dividends" on the unissued shares.

45 The payments of R2m and R650 000 to Levenstein and the allocation of 5m shares ("the additional remuneration") are subject to these criticisms:-

45.1 The additional remuneration was not properly authorised:-

- The award of additional remuneration was not in accordance with Holdings articles of association.
- The boards of Holdings and the bank did not approve the additional remuneration.
- The boards did not authorise the non-executive directors to agree to the additional remuneration.
- There is a dispute of fact amongst the non-executive directors whether they did authorise the additional remuneration. Lurie said that all the non-executive directors agreed to the additional remuneration at a meeting on 25 January 2000. Buch testified that at that meeting the non-executive directors agreed that the terms and conditions on which the additional remuneration would be paid should first be established. Levenstein was so upset that there had not been automatic acceptance of his proposals that it was decided to discuss the matter the next day. On the following

day, 26 January 2000, all the non-executive directors agreed that the shares would be restraint shares and that the R2m bonus was to be based on Levenstein's performance in the future. Nhleko denied that he had agreed to Levenstein's request. He testified that Levenstein threatened to resign within days if his demands were not met. Nhleko found Levenstein's attitude abrasive. On 26 January 2000 he wrote a letter to Lurie in which he called for the establishment of a remuneration committee in accordance with the King Report and that that committee should review not only Levenstein's remuneration but that of all company employees. J Pollack could not remember the R2m bonus and the 5m share allocation. Kaminer's evidence was that he did not approve the R2m bonus. His evidence was that at a breakfast meeting the 5m shares were discussed. The directors wanted a meeting with Levenstein to discuss the allocation, but Levenstein did not arrive, and that was that.

- Lurie testified that the executive directors later agreed to the additional remuneration. Two of the executive directors disputed that they had ever agreed. Diesel testified that his approval was never sought and never given. He became aware of the R2m bonus only when it was paid. Lopes testified that he was told by Diesel that R2m had been paid to Levenstein. He saw documents on the desk of Brian

Levenstein which recorded the bonus and the allocation of 5m shares. Lopes was stunned. Levenstein told his colleagues that they were not entitled to receive any bonuses as he was the only one who deserved a bonus as he brought in 90% of the income.

- At an audit committee meeting of 9 November 2000 it was recorded that the R2m bonus had been passed by a resolution on a round robin basis. There was no round-robin resolution. The minute is incorrect.

45.2 The payments were at variance with Levenstein's policy on remuneration. He believed in a "culture of sacrifice" for the directors and employees (but a "culture of greed" for himself). Non-executive directors received no remuneration. Executive directors were underpaid. Their remuneration packages were significantly below the lower quartile of the market in terms of guaranteed package. The policy was to pay below market norms and to use the share option scheme as a potential means to increase remuneration. In early 2000, Levenstein, backed by some of the non-executive directors, decided that what was good for the goose was not good for the gander. He was to be paid far more than his fellow executive directors and his salary for the year was to jump from R413 000, less tax, to that amount plus R2 650 000. This amounted to a 741% increase in remuneration for that year.

45.3 It was fraudulent to describe the payment of R650 000 as "dividends" as no shares were ever issued. The payment was described as dividends to avoid the payment of personal income tax. The payments should have been disclosed by Holdings, the bank and Levenstein as remuneration.

45.4 The payment of R2m, as requested by Levenstein and approved by some of the non-executive directors, was a cash bonus for "efforts for Regal from inception to date", in the words of the letter of 29 December 1999. It was on that basis that some of the non-executive directors agreed to the payment. As a bonus, it should have been disclosed by Holdings, the bank and Levenstein as remuneration. Ernest & Young ("EY"), however, were not aware of the letters of 29 December 1999 and 27 January 2000 (in which Levenstein recorded the alleged agreement of the non-executive directors to the bonus). The R2m payment was reflected in EY's working papers as intellectual property, but there was no reference at all to that amount in the financial statements. It must have been included in fixed assets of R39m. Yet goodwill and intellectual property were not shown separately in the captions for fixed assets. It follows that the payment of R2m was hidden in the financial statements. No reader of those statements would have known that Levenstein had received R2m. In one of the working papers, EY recorded that "Regal has subsequently agreed to disclose this [the R2m payment] as director's emoluments and expensed the assets over 20 years." The payment was not, however, shown as director's remuneration in the financial statements. All that was disclosed to the auditors was that Levenstein earned a basic salary of R413 000.

46 In the early part of the year the BSD conveyed its concerns about corporate governance at Regal to EY and Regal. At a meeting with EY on 28 January 2000 it was minuted that "the board was run by management and was not perceived by BSD to be totally independent… It was concerning to BSD that Mr Jack Lurie, newly appointed chairman of the board, was the [brother]-in-law of Mr Levenstein. It was BSD's viewpoint that Mr Levenstein was playing an over-dominant role in the bank." On 3 February 2000 the Registrar wrote a letter to Lurie in which he referred to his letter of 1 October 1999 in which the statement had been made that it was strongly advisable for the bank to appoint new non-executive directors to the board in order to replace Lubner and Schneider. The Registrar reiterated his opinion. On 17 February 2000, Lurie responded by stating that "we are determined that the replacement directors will be of a calibre that adds value to the organisation. … I am also currently in consultation with other potential candidates as to their suitability." On 22 March 2000 the Registrar wrote a letter to Lurie in which he requested that a meeting be arranged "regarding the progress made towards ensuring that the composition of the board of directors of your bank complies with the

provisions of the Bank's Act, 1990, and the principles of sound corporate governance." The Registrar and Martin met with Lurie and Levenstein on 17 April 2000. The Registrar questioned the independence of the non-executive directors and stressed that the BSD wanted to avoid a situation where the executive directors prescribed to the non-executive directors and the latter were not in a position to be totally independent. Levenstein replied that Regal was considering the appointment of a totally independent chairman from outside the group.

47 Once again, however, Holdings and the bank ignored the BSD. No independent chairman was appointed in 2000 nor were new non-executive directors appointed. Unknown to the BSD, another example of a failure of corporate governance had occurred in early 2000 with the payments of R2m and R650 000 and the agreement to allocate 5m shares. And much worse was about to come.

48 In early April 2000 EY identified an issue relating to the recognition of income derived from branding in the 2000 financial year. The amount Levenstein wished to be included was R55m. In a handwritten note he justified R50.8m on this basis:

RMI	R23m
Kgoro	R15m
Medsurg	R8m
Protea Health	R4.8m
Total	R50.8

Senior management of EY immediately applied their minds to the question: Wixley, the chairman, Coppen, a technical partner, Strydom, a partner, and Van Heerden, the engagement partner. In the result, EY prepared a document for discussion at the audit committee meeting scheduled to take place on 12 April 2000. EY took the view that no branded income should be recognised. The audit committee met on 12 April 2000. No agreement could be reached on the correct treatment of a number of issues, including income from branding. The meeting ended on the basis that independent valuations would be obtained and the announcement of the results would be postponed. On the following day, 13 April 2000, Wixley and Van Heerden met with Levenstein. The EY representatives remained unconvinced at the end of the meeting by Levenstein's views on the valuation of the branded entities and what income was to be taken into account. EY and Levenstein thereafter corresponded on the issue. No agreement could be reached.

49 Some time prior to 18 April 2000, management gave instructions to a printer to print the "Preliminary results for the year-end 29 February 2000" ("the results of 18 April"). The results were never published. Their significance, however, lies in the following:-

- The audit committee did not approve those results. The audit committee meeting on 12 April 2000 did not approve *any* results inter alia because of the branding income dispute between Levenstein and EY.

- The board of directors could not have approved the results for the same reason. There is not even a minute of a board meeting at which the results were discussed. There was a suggestion in evidence by Buch that a board meeting was scheduled for 12 April 2000 and that one took place on that day. But there is no minute of such a meeting. The meeting of 26 March was the 51st meeting and the meeting of 24 May was the 52nd meeting.
- The results of 18 April contained these material entries:

	29/02/00	28/02/99
Other income	R76.6m	R17.7m
Operating expenses	R35.4m	R17.7m
Income before taxation	R99m	R50.2m
Earnings per share (cents)	79.96	48.10

- If the amount of R55m for branding income proposed by Levenstein is excluded, income before taxation would be R44m, less than the profit for the previous financial year (R50.2m).

50 On 26 April 2000 Regal Holdings obtained two valuations from Intellectual Property Valuators ("IPV"), one for Kgoro at between R126.9m and R177.7m and the other for RMI at between R92.4m and R129.4m. On 4 May 2000, Cooke of EY provided his valuations: R1m for Kgoro and R20.5m for RMI. On Cooke's valuations, Regal Bank's 25% share of those values was R250 000 and R5.1m respectively.

51 On 4 May 2000 EY and Levenstein met and discussed these highly disparate valuations. No agreement could be reached. EY informed Levenstein that if the Regal figures were not amended, EY would qualify the report. Levenstein said they should do so. EY offered to resign, an offer which was not taken up. On the same day, Levenstein wrote a letter to the Registrar in which he stated: "I have created a highly complex banking model, which transitions Regal into the New Economy. E & Y are struggling to blend Old Economy accounting standards with my model sophistication.

A dispute will accordingly crystallise into significant focus. I respectfully contend that they have deflected attention away from its complexities in order to simplify their task." On 5 May 2000 the BSD and EY met. EY explained the Regal branding model, said that there was disagreement between them and Levenstein on the valuation of the investments and how those were to be accounted for in terms of GAAP. The Registrar telephoned Levenstein and said that if EY qualified the 2000 financial statements, he would appoint a curator. The discussion ended on the basis that KPMG would be appointed in terms of <u>s7</u> of the Banks Act to give a view.

52 Before KPMG produced their report on 15 May 2000, Levenstein continued to make the case that EY was wrong and he was right. On 5 May 2000 he wrote a letter to Van Heerden of EY in which he referred to EY's draft audit opinion as "unjustified and iniquitous" and stated that

: "We remain committed to our financials." On the same day, Levenstein wrote a letter to the Registrar in which he contended that EY had not applied themselves professionally; that he was confident that KPMG would share his sentiments; and that there was absolute agreement that he had created a significant banking product that could revolutionise the banking industry. On 14 May 2000, Levenstein wrote a letter to the Registrar in which he repeated his views, with comments from other commentators, and stated that "the qualification envisaged by Ernest & Young is totally unjustified and indeed irresponsible". He added: "Regal and myself remain totally committed to the year-end financials approved unanimously by the board and the audit committee." Levenstein's statement that the year-end financials had been approved by the board and the audit committee was false.

53 On 15 May 2000 KPMG produced its s7 report. A coherent explanation of Levenstein's "branding concept" was set out in the report in these terms:

"Regal considers the essence of each of the trade-mark licence or branding transactions to be:

- Regal's banking infrastructure is superimposed on the underlying branded entity.
- Regal and the branded entity gear annuity flows from their respective operational platforms.
- The branded entity has full intellectual and logistical access to Regal.

- Regal’s banking model is enhanced by the brand control over the underlying entity, which in itself has intellectual capital, expertise and experience, market access and client bases.
- The branding model has the ability to attract talented entrepreneurs in innovative alliances at no cost to Regal.
- The branded entity inherits the profile and operating divisions of a bank without incurring the cost of capital associated with banking.
- Branding through the licence agreement secures control.
- Regal has no desire to control the company or impose its will on the branded entity; it has no desire to have representation on the branded entity’s board or craft its strategic future.
- A fee is charged for the ‘infusion of economic value’ into the branded entity. Regal accepts equity participation in settlement of the licencee’s obligations in lieu of cash. Regal considers the equity received as a principal investment, the cost of which equates to the licence fee billed and settled between knowledgeable, willing parties in an arms length transaction.”

The branding model was measured by KPMG against AC000. The standard to be met for income to be recognised is: “It can be measured in monetary terms with sufficient reliability.” KPMG found that the proposed branding income could not be measured in monetary terms with sufficient reliability. In regard to “fair value” the standard of AC111 §09 is: “The amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arms length transaction.” KPMG came to this view: “For an unlisted

> investment in an entity that does not have a proven track record, the range of fair value estimates is generally significant. Therefore it is generally not possible to measure the fair value reliably. … Given the two new starter ventures, RMI and Kgoro, do not have proven track records as at 29 February 2000, it is difficult to assign an absolute fair value to the license fee underlying these transactions. This in turn indicates that we are unable to measure fair value with certainty."

54 Louw, the chairman of the KPMG forensic and investigative accounting group and managing partner of the financial services group, gave evidence. He confirmed the contents of the KPMG report. He emphasised that because income could not be measured "in monetary terms with sufficient reliability", it was inappropriate to recognise <u>any</u> income. Louw expressed the opinion that the purpose or main driver of the branding model was to increase the income of the bank, which might translate into a re-rating of the share price.

55 On 15 May 2000 the Registrar and members of the BSD held four meetings with (1) KPMG, (2) KPMG and Levenstein, (3) EY; and (4) EY, Lurie and Buch. At the first meeting KPMG presented its report to the BSD. At the second meeting, the KPMG report was put to Levenstein. Levenstein explained that he was "the only person who could render an opinion on the value and measurement of [branding income]" and that he would stick to his opinion. Levenstein stated that EY had

conducted an inappropriate audit and that it was not clear to him why the financial history of the underlying entities could not be detected. The Registrar replied that the BSD would rely on the opinions of EY and KPMG and that if Holdings were to publish qualified financial statements, the BSD would deregister the bank. Levenstein's response was that he would issue the financial statements, even if qualified by EY, regardless of the consequences. At the third meeting, the Registrar conveyed to EY that the BSD had three options: to appoint a curator; to apply to Court to deregister the bank or to remove Levenstein as CEO of the bank. Van Heerden of EY expressed the opinion that the board would not agree to the removal of Levenstein as CEO. The Registrar questioned whether Levenstein was fit and proper to run the bank if he was prepared to act against the advice of KPMG, EY and the Registrar. At the fourth meeting, Lurie and Buch both supported Levenstein's opinion that branding income should be recognised. Buch said that the audit committee was "comfortable with the way the transaction was accounted for and conveyed his surprise of the outcome of the KPMG report". He said that it was not clear to him why EY could have a problem with the valuations done by the independent valuators. The meeting concluded by Buch enquiring whether EY would approve the financial statements if their assessment of branded income, R5.5m, was accepted by Regal.

56 The Registrar conceded in evidence that Levenstein's conduct in rejecting the opinions of EY and KPMG and adopting the attitude that

he would go ahead with publication of the audited results even if qualified by EY (an attitude that would effectively lead to the closure of Regal Bank), was irrational and stubborn. But, said the Registrar, “We did not have any powers … to do something about it … Obviously it did create some reservation in our minds and that is why we expressed it to [the directors]”.

57 From a mass of confusing and contradictory evidence one must try to pierce together what happened at Regal Bank on the night of 15 May 2000 and the day of 16 May 2000, i.e. between the meeting Buch and Lurie held with the BSD on 15 May and the publication of the “Audited results for the year ended 29 February 2000” (“the results of 16 May”) in the evening of 16 May 2000. The most probable version is that Lurie and Buch, on their return to the bank from Pretoria, persuaded Levenstein “over a couple of hours”, in the words of Buch, to back down. Levenstein, Lurie and Buch eventually agreed that only R5.5m of branded income would be recognised. During that period, Levenstein instructed Davis, then CFO: to prepare a document for transmission to EY in which branded “expenditure” of R22m was justified; to defer R6m of branding expenditure; and to obtain the approval of EY to the amended financial results. Because Levenstein was compelled to reduce branding income from R55m to R5.5m he had to find a way to avoid the 2000 results being worse than the 1999 results. The device employed by him was to defer R6m of branded expenditure. Davis duly

prepared a letter addressed to EY on Levenstein's instructions which purported to show branding "expenditure" of R22m, most of which Davis knew did not qualify as expenditure in terms of GAAP and would not be recognised by EY. Van Heerden of EY was out of town late on 15 May 2000 and the day of 16 May 2000. He did not receive Davis' letter. EY did not approve the results of 16 May. There was also no audit committee or board approval of the results.

58 Faced with the absence of a record of a meeting of either the audit committee or the board, Levenstein, Lurie and Buch struggled in evidence to explain when, how and by whom the results of 16 May were approved. Lurie, the chairman of the board, did not call a meeting of the board of Holdings on 15 May 2000 or the next day. He could not explain why he did not do so. Lurie testified that he spoke to all the directors on 16 May 2000 and that they informally approved to publication of the results, a version which was in conflict with the evidence of other directors. He could not recollect whether the directors had seen the results at the time of the discussion. Levenstein contended that the board did approve the results, even though the board did not meet. He said there must have been a round robin resolution, which might not have been in writing. He could not say which directors approved the results. He admitted that the audit committee had not met to approve the results. Buch's testimony was that an informal meeting of the audit committee took place on the night

of 15 May 2000, which he and Levenstein attended. The other member of the committee, Slender, was away and could not be contacted. There was no time for a formal meeting. On 16 May 2000, so Buch testified, he was not at the bank. He had no contact with anyone at the bank that day. He did not attend an audit committee meeting or a board meeting or sign a round-robin resolution or approve the results in any way.

59 The evidence of the other directors added to the confusion. Lopes testified that Davis told him that EY had approved the results that were to be published later that night of 16 May. There was no board meeting and no audit committee meeting to approve the results. J Pollack could not remember the events of April/May 2000. Kaminer could not remember whether there was a board meeting which approved the 2000 results; he could not remember that period, but he thought “they did approve it”. Radus could not remember whether he approved the results. He was not involved with the events of 15 and 16 May 2000. He could not remember the events of 16 May. Diesel was not involved in any way on 15 and 16 May 200 in approving the results; he was trying to do damage control; he concentrated on his areas of responsibility.

60

60.1 The results of 16 May were signed by Lurie, chairman, and Levenstein, chief executive officer, of Regal Holdings.

60.2 The material entries were:-

	28/2/00	28/2/99
Other income	R27m	R17.7m
Operating expenses	R29.4m	R17.7m
Income before taxation	R55.5m	R50.2m
Earnings per share (cents)	50.01	48.10

60.3 A comparison of those entries in the results of 18 April and 16 May is:

	18 April	16 May
Other income	R76.6m	R27m
Operating expenses	R35.4m	R29.4m
Income before taxation	R99m	R55.5m
Earnings per share	79.96	50.01

60.4 Included in other income in the results of 16 May was only R5.5m of branding income, hence the huge difference between other income and income before taxation between the results of 18 April and 16 May.

60.5 Operating expenses were reduced by precisely R6m, being the deferred expenditure in branding.

60.6 In a new section called “Banking Model”, written by Levenstein, it was stated inter alia:

“The model has, and will create enormous wealth for shareholders.

Regal are in disagreement with the Auditors regarding the disclosure and treatment of certain investment securities created by the model. By appointment the complexities and design features of the model are available for inspection and discussion at Regal's Rivonia office. Notwithstanding Regal's emphatic assertion that transactional norms have created and entrenched value for its investments securities, Regal has mandated Independent third party valuation specialists to report on the pricing value for its investment securities. Regal has mandated Independent third party valuation specialists to report on the pricing models that regulate treatment and disclosure; same are available for inspection. The reports endorse the Regal perspective regarding value. The divergence between old and new accounting standards manifests in a so-called valuation difference of R30.5m, after taxation, reducing earnings per share by 30 cents.

The Board approved the year end results reflecting earnings per share of 79.96 cents. At the request of the Registrar of Banks we have agreed to defer the valuation difference. <u>All expenditure incurred to generate this income had been written off in the current year. We estimate that approximately R18m of expenditure relating to the new model has been accounted for on this basis</u>. Generally accepted accounting practice allows for the setting off of this expenditure against the income deferral. Regal, as detailed above, has absorbed the full brunt of this expenditure in the current year. Regal is thus positioned very powerfully for the ensuing year." (The underlining is provided.)

61 The results of 16 May contained the following material fraudulent misrepresentations:-

(1) The document contained an implicit representation that the results had been approved by the Holdings board. The board had not approved the results.

(2) The results were described as "audited", whereas EY had not seen the results before publication, let alone approved the results.

(3) The express statement that: "The board approved the year-end results reflecting earnings per share of 79.96 cents" was false. The board did not approve the year-end results and had not approved earnings per share of 79.96 cents. At a joint board meeting of 26 March it was minuted that "a dividend cover of 13 cents a share, being six times cover, was agreed upon."

(4) The R18m of branding expenditure referred to in the section on banking model did not exist. To this day, no one, including Levenstein, the CEO, and Davis, the CFO, could provide any substantiation for that amount. Simply put, the figure was a figment of Levenstein's imagination.

(5) The statement that all the branding expenditure had been accounted for or written off in the current year was false. R6m in branding expenditure was deferred.

62 The results of 16 May were misleading as much for what they did not disclose as for what they did disclose. It was not disclosed that:-

(1) the bank had sought recognition of R55m of branding income and that only R5.5m of branding income had been recognised by EY, incorporated in the results, and agreed to by Lurie and Levenstein;

(2) an amount of R6m of branding income had been deferred;

(3) EY had threatened to qualify the financial statements if Holdings insisted on including the amount of R55m for branding income;

(4) KPMG was appointed by the Reserve Bank to review the different valuations provided by EY and Holdings;

(5) KPMG supported EY in principle and had opined that no income should be recognised for the branded entities.

63 Faced with the publications on SENS on 16 May 2000 and in the morning newspapers of 17 May 2000 of the results of 16 May, EY wrote a letter to the directors of Holdings on 17 May. A copy of the letter was sent to the Registrar. A number of comments were made in the letter, including that the announcement was made without submission to EY as requested; that the announcement was not considered at a formal meeting of the audit committee; that although the changes had been explained to EY telephonically, they had not yet had an opportunity to check the entries; that a number of inaccuracies appeared in the "banking model" section. A correcting statement was called for in which Holdings was required to state that:

- the figures set out in the announcement were in accordance with GAAP and had the full approval of the directors;

- the changes to the financial statements were made following discussions with the auditors and were not made at the request of the Registrar of Banks; and
- the references to earnings per share of 79.96 cents in the announcement should be ignored.

EY stated in the letter that although they were not in full agreement with the changes to the entries, the differences did not materially affect the fair presentation of the company's results or its financial position, and subject to appropriate disclosure in the annual financial statements they were prepared to issue an unqualified opinion on the figures contained in the announcement.

64 Despite the fact that it failed to deal with all their concerns, a retraction by Holdings was published on 19 May 2000 which satisfied EY.

65 The actions and by EY on 17 May 2000 were hopelessly inadequate. EY had statutory duties in terms of the Banks Act and the Public Accountants and Auditors Act, Act 80 of 1991 ("PAAB Act"). In terms of <u>s63(1)</u> of the Banks Act the duties are as set out in 15.2 of Part One. The duties of an auditor in terms of the PAAB Act are set out in §15.3 Part 1.

66 EY were in breach of those statutory duties:-

66.1 What was known to EY on 17 May 2001 was that:

- Holdings had published the results of 16 May without the approval of EY;
- the description of the results as "audited" was false;
- Holdings had published those results without the approval of the audit committee;
- the operating expenses had been reduced by R6m on the basis that R6m of branded expenditure had been deferred;
- the branding expenditure could not be measured reliably and in terms of AC000 § 89 the deferral should not have been recognised;
- the reference to R18m of branded expenditure was false;
- the statement that all branded expenditure had been taken into account or written off was false because R6m had been deferred;
- the Holdings board did not approve earnings per share of 79.96 cents.

66.2 Wixley testified in evidence that EY was willing to accept the R6m deferral because he and Van Heerden felt that "there was a basis for some small adjustment [R3m] and that viewed on balance the adjustment of 6m was not material to an appreciation of the financial results of the company or its financial position". Wixley said that he was not aware whether EY "were happy with the statement that approximately R18m of expenditure relating to the new model had been accounted for … I can only assume that at the time we believed that that was a reasonable statement".

66.3 The R6m deferral of branded expenditure, however, was significant way beyond its quantum:

- the expenditure had been deferred without EY's consent;
- the deferral of R6m of branding expenditure was contrary to AC000 § 89;
- without the deferral Holdings would have made less profit in 2000, R49.5m, than it had made in 1999, R50.2m.

66.4 On 17 May 2000 Holdings did not provide EY with any proof of the R18m branded expenditure. The only "proof" that EY was given related to the R6m. Davis' evidence was that he had obtained that amount from Levenstein (who relied in evidence on a document prepared by Davis!). When he was asked by EY on 18 May 2000 to justify the amount, he made this note: "At half-year expenses were R13.2m. Without increasing infrastructure to incorporate model expenses for year would be ±R26.5m. The expenses were 35.4m therefore effective branding model ±9m, R6m adjustment to expenses debited to prepayments". EY could not possibly have believed that a speculative calculation such as that complied with GAAP.

66.5 The publication by Lurie and Levenstein of the results of 16 May 2000 was fraudulent. Fraudulent conduct is an irregularity in terms of s63(1)(a) and/or a matter which might endanger the bank's ability to continue as a going concern or might impair the protection of the funds the bank's depositors or might be contrary to the principles of sound management or might amount to inadequate maintenance of the internal controls in terms of s63(1)(b).

66.6 EY seemed to suffer from battle fatigue. They were relieved to have achieved the publication of an unqualified set of financial results. Their letter of 17 May 2000 must have lulled the Reserve Bank into believing the crisis was over. Had EY, however, pointed out that the results of 16 May 2000 were fraudulent, the Reserve Bank could have taken the appropriate steps in May 2000 to change the composition of the board and replace Levenstein. The nature of the appropriate steps is dealt with later in relation to the DT s7 report.

67 The statutory financial results ("the glossies") were published in about September 2000. Meetings of the Holdings board were held on 24 May,

28 June, 26 July and 30 August 2000. At none of those meetings did the board approve the results contained in the glossies.

68 The financial statements in the glossies were misleading in these respects:-

- In the Directors' Report it was said that the Incentive Trust was not operational at year-end whereas it was in fact operational and had been advanced R15m for the purchase of Regal Holdings shares to that value.
- The allocation of 5m shares which Regal Holdings agreed to make to Levenstein was not disclosed contrary to §10 of the Fourth Schedule to the Companies Act.
- In the balance sheet pre-payments of R7m were shown. The amount of R7m included the R6m deferred branding expenditure. The amount of R6m was sufficiently significant to warrant accurate disclosure as deferred expenditure.
- The R18m expenditure referred to in the "banking model" section of the results published on 16 May was not dealt with at all.
- A deposit of R164m was shown "from other banks", whereas in truth at least R150m of the deposits had been made by Mettle SPV's, which were not a bank.
- Branding income of R5.5 should not have been recognised as it could not be measured in monetary terms with sufficient reliability.

- R6m of branding expenditure should not have been deferred as any expenditure on branding could not be reliably measured.
- The statement was made that "there are no significant concentrations of credit risk" whereas in fact Holdings was exposed to Mettle or SPV's for at least R150m.
- Negotiable securities in an amount of R227m were shown. Included in that amount were preference shares of R150m, which should have been disclosed in those terms.
- If the R2m payment to Levenstein was "intellectual property", intellectual property should have been shown separately in the captions for fixed assets.
- The R2m was in truth remuneration as it was a bonus for past services. It should accordingly have been disclosed as part of directors' remuneration.
- The earnings per share should have reflected fully diluted earnings per share, taking into account the obligation to issue 5m shares to Levenstein.
- Disclosure was made of "related party transactions", but no disclosure was made of moneys lent to related parties such as Levenstein Data, JL Associates, Forfin Finance (Pty) Ltd ("Forfin") and Shareholders Trust.

69 On 5 September 2000 Regal Holdings published its "unaudited results for the six months ended 31 August 2000" ("interim results for 31

August”). Income before taxation was R49.5m (compared to R55.5m for the whole 2000 financial year).

70 A major breakthrough in corporate governance for Holdings occurred in that the audit committee approved the interim results on 4 September 2000 *before* they were published.

71 However, EY were not invited to the audit committee meeting. Levenstein was asked to explain. His explanation was that it was “pure naivety”; it was not done maliciously or wilfully. In giving that evidence he had forgotten about an undated memorandum which he had addressed to Buch and Davis, according to him, during the 2000 audit in these terms: “An audit committee should now be convened as a matter of urgency to approve the financials. EY are not formal members of the committee, they accordingly must not be invited”. He justified the instruction on the grounds that Strydom of EY was party to a political agenda and that Strydom and the auditors could not be trusted.

72 EY should have been invited to attend all audit committee meetings, especially meetings at which interim and final financial results were to be discussed. EY attended only one meeting out of five in the calendar year 2000.

73 The failure of Holdings to invite EY to attend the meeting of 4 September 2000 was egregious having regard to:

- Holdings' failure to hold an audit committee meeting before the publication of the results of 16 May;
- the branding income dispute between Levenstein and EY which arose during the 2000 audit;
- the recommendation of the King Report that external auditors should attend all audit committee meetings;
- the practice in the banking industry that external auditors attend all audit committee meetings. Louw testified that KPMG are the auditors of twenty-three banks and they attend every audit committee meeting of all those banks.

74

74.1 If the adjustments contended for by EY in evidence had been made to the interim results of 31 August 2000, a nominal profit of R650 000 would have been shown instead of the profit of R49.5m:

Profit before tax in announcement	49,5
Less:	
[A] 50% of errors rectified at year-end:	
• Overestimate of pref dividends	13,4
• Underestimate of depreciation	,3
• Bank expenses in Shareholders Trust	1,3
• Bad debt provision	4,0
[B] Reductions due to non-disclosure:	
• RMI: proceeds of sale	20,5
• RMI: 2000 valuation	5,5
• RMI: Elul fee	2,7
[C] Consolidation of Incentive Trust: elimination of interest to accord with year-end treatment	1,2
Subtotal	**48.8**
Total	**,65**

74.2 This does not take into account:

- potential losses on advances to employees and directors and/or the Incentive Trust (±R18m) and potential impairment to the Shareholders Trust (±R18m) (DT(1) 30-32);

- the payment of R650 000 to Levenstein as “dividends” (which was included as a debit balance in creditors at 31 August 2000 instead of being written off (DT(1)28);
- advances to directors and senior managers in the amount of R2.6m (referred to in §90.1 of Part Three and DT(1)38).

75 Unlike the dismissal of Mark Springett, the dispute about branding income was public knowledge. First there was the delay in the publication of the financial results from 18 April until 16 May 2000. Then there was the threat by EY to qualify the 2000 financial statements if all the branding income was included, a threat that was not carried out because only a nominal amount was eventually recognised. The erosion of confidence in the bank had begun. The share price plunged from a high of 815c on 25 January 2000 to a low of 315c on 25 May 2000.

76 On 14 August 2000, Lopes, a director of Holdings and the bank and chief operating officer of the bank, met with the Registrar. Lopes made over 30 allegations about the management of the bank. Some of the allegations were that:

- board members who did not agree with Levenstein were removed from the board;
- the bank had lost about twenty-five staff members, ten of them in senior management positions, within the past three months;

- about 95% Regal Holdings shares were being purchased by the bank;
- anyone who questioned Levenstein's branding idea were threatened;
- Levenstein's personal expenditures were paid by the bank without board approval.

77 The Registrar testified that the visit by Lopes to the Reserve Bank "highlighted certain things and that sort of solidified our opinion that we needed a [s7] report". The Registrar acted with commendable speed. On 16 August 2000 he met with Deloitte & Touche ("DT") with a view to the appointment of DT to do the s7 review "on the role of the board of directors, particularly the powerful role played by the CEO". It is recorded in the minutes of that meeting that if Lopes' allegations were confirmed "a meeting will be held with the shareholders with the intention of removing Mr Levenstein and/or dissolving the whole board". On 23 August 2000 the Registrar, Martin, and other members of BSD met with Lurie and three non-executive directors to discuss the Registrar's concern "about the recent dismissals and resignations at Regal. Negative market perceptions had influenced the share price and there were allegations of mismanagement within Regal." A discussion ensued about corporate governance, the branding strategy (which Lurie said would no longer be completely relied on); allegations of possible financial irregularities

and so on. The meeting concluded with support by the directors for "a s7 review on corporate governance" by Store and Schipper of DT.

78 By 6 September 2000 Schipper had done enough work to be able to report back to the Registrar. A meeting was held on that day between the Registrar, Martin and other members of the BSD and Store, Schipper and Oberholzer of DT. Schipper reported on many of the issues which are contained in the written report, to which reference is made later. It was minuted that the Registrar expressed the opinion that Regal Bank had no future and that it would be requested to deregister voluntarily. Schipper indicated that he needed more time to finalise his report. The meeting adjourned on that basis. On 4 October 2000 another meeting took place between DT and BSD. Store conveyed to BSD that the bank was solvent and had a high capital base. Various issues that were to form part of the written report were canvassed. The Registrar expressed the wish to replace Levenstein, as did Martin. The Registrar noted that the BSD had lost trust in Levenstein's ability to run the bank. Schipper said that he needed another week to finish the report. On 23 October 2000 the Registrar and the BSD were in a position to meet with the board of directors of Holdings. The meeting was attended by ten representatives of Holdings, including Lurie, Levenstein and Buch, the BSD, Rooth & Wessels and Schipper of DT. The Registrar made a slide presentation which dealt with the rationale for the s7 review, an overview of the

terms of reference, the BSD's views of the findings and overall observations. A draft report was tabled, which Schipper indicated could be regarded as the final document. Levenstein dealt in some detail with many of the issues raised in the slide presentation. At the conclusion of the meeting it was agreed that Holdings would prepare a written response to the DT s7 report.

79 The Registrar testified before the commission that if he had had the power to do so at the time, he would have removed Levenstein "right there and then" and he would have had the board of Holdings reconstituted; unfortunately, he did not have the power to do so; all he could use was "moral suasion". He believed, on the basis of the DI returns, that the bank was complying with its prudential requirements. Had there been deficiencies in the prudential requirements, the Reserve Bank would have acted a lot faster. Martin's evidence before the commission was that, acting on the advice of the Reserve Bank's attorney, the presentation by the Registrar to the Holdings directors on 23 October did not include the corrective actions which the BSD required the board to take. The actions the BSD wished the board to take included the following:

- the appointment of a new chairman who was independent and seen to be independent;

- the appointment of at least four independent, non-executive directors, at least two of whom should have had extensive banking experience;
- the appointment of a new CEO.

80 There is no doubt that the Registrar and Martin were justified in coming to the conclusion that Lurie and Levenstein should be replaced and that new suitably qualified independent non-executive directors should be appointed to the board. The DT s7 report gave the BSD an objective view by an independent expert of the inner workings of Regal Bank. The report consists of fifty-two pages. These are some of the highlights:

- most of the committees had no founding documents or formal terms of reference;
- many of the committees did not keep minutes;
- Levenstein sat on seven of the eight committees and was chairman of five of the committees;
- none of the non-executive directors had any banking experience, including the chairman, Lurie;
- Lurie was Levenstein’s brother-in-law and the perception of his independence was tainted;
- a number of senior executives had been dismissed without due process;

- money was lent by Regal Bank to the Shareholders Trust to buy Holdings shares;
- from March 2000 the purchasers "by Regal" comprised a significant proportion of the daily activity, on occasions as much as 90% of daily movements;
- payments in the sum of R2.6m had been made to directors from December 1996 to July 2000 "from a bank account outside the bank's accounting systems" as advances against bonus incentives;
- personal expenditure of Levenstein amounting to R9 850 per month was paid by the bank;
- the remuneration of all the bank's executives lay significantly below the lower quartile of the market in terms of guaranteed package;
- non-executive directors were not remunerated;
- there were no service contracts for executive and non-executive directors;
- the remuneration policy was not documented nor formulised;
- the lack of procedure for the appointment and dismissal of directors and senior management was a cause for concern;
- the Regal group was overly dependent on Levenstein's vision and management;
- there was no proper infrastructure below the chief executive officer;
- the payment of R650 000 to Levenstein as "dividends" on unissued shares;

- the advances made by the bank to Shareholders Trust were in total R36m against the security of Holdings shares to a value at that time, 31 August 2000, of R17.6m only;
- the Incentive Trust was indebted to the bank for R51.4m against security of R33m;
- there were loans to directors and related parties in the sum of R96.4m.

81 Schipper testified that drafts of the DT s7 report were discussed on various occasions with Van der Walt, Davis and Levenstein. By the time the report was finalised, the factual allegations were common cause between DT and Regal Bank.

82 The DT s7 report and the conduct of Levenstein during the 2000 audit, which was known to the BSD, demonstrated that Levenstein was unfit to be CEO of the bank and Lurie and the non-executive directors were either supporters of Levenstein, unfit as he was, or incapable of exercising control over Levenstein.

83 The time had come, if it had not passed a year before, for action by the BSD. In the words of an authority quoted by the Registrar in his evidence:

"To be effective, corrective action must be fair, swift and decisive."

The BSD had decided on the corrective action – the removal of Lurie and Levenstein, the appointment of at least four suitably qualified independent, non-executive directors, and the appointment of a new chairman and CEO. Time was of the essence. What remained was "fair, swift and decisive" execution of the corrective action. In the result what happened may have been fair - giving Holdings an opportunity to respond in writing to the DT s7 report – but it was neither swift nor decisive, leaving Levenstein in place as CEO until 18 June 2001, by which time the death-knell of the bank had been sounded.

84 Holdings responded in writing to the DT s7 report on 29 November 2000. The body of the report consists of nine pages. The response is superficial. No material disputes of fact were raised. Two of the allegations in the DT report which were denied were that the committee structure was weak and that Levenstein was in an overly dominant position on the committees. Presumably, that denial was done tongue-in-cheek. Remedial steps were said to have been taken, such as taking minutes of meetings, and to be taken, such as outsourcing the human resource function to DT Human Capital Corporation and "strengthening the ranks of non-executive board members". The DT concern about the shortfall between the loans to the trust and the value of Holdings shares was addressed by reference to a transaction described in these terms: "Mettle Ltd has acquired 8 million shares at a price of R5.50 per share from the trust. The purchase price is in excess of the average price at which

the trust had bought the shares." As will be shown later, that description of the Metshelf 1 transaction with Mettle amounted to a fraudulent non-disclosure.

85 On receipt of the Holdings response, the BSD could not have been persuaded that the steps they wished to take, including the removal of Levenstein, were not warranted. If anything, the Holdings response should have reinforced the BSD's concerns and prompted "swift and decisive" action by removing Levenstein, as a minimum.

86 Instead, what the BSD did was:

- to instruct lawyers to give it legal advice on various issues unrelated to the removal of Levenstein;
- to insist that Holdings – led by Lurie and Levenstein – take corrective measures (which did *not* include the replacement of Lurie and Levenstein with more suitable candidates);
- to instruct EY on 12 February 2001, more than two months after receiving the Holdings response, to verify that remedial steps had been taken by completion of the year-end audit.

87 The Registrar complained that he did not have the power to remove Levenstein. True, but he could have used "moral suasion" backed by the threat of curatorship or an application to deregister the bank. He had played that hand very effectively on 15 May 2000, the

consequence of which was that the 2000 financial statements were not qualified by EY. He did not even put his action plan to the board, let alone try to persuade the board to agree to it.

88 To underline the urgent need to change the composition and leadership of the Holdings board in October/November 2000 four events in the latter half of 2000 are analysed:

- the resignation and subsequent harassment of Lopes;
- the response of the directors to the DT s7 review;
- the conclusion of more Mettle deals by Levenstein and the lack of understanding of the directors of those transactions;
- the purchase by Regal Bank of Worldwide's Regal Holdings shares on 29 December 2000 for R60m and the subterfuge that was employed to disguise the true nature of that transaction in the records of Regal Bank.

89

89.1 On 18 August 2000 Lopes went to work. While he was in his office Levenstein approached him on three separate occasions. The essence of the message which Levenstein gave Lopes was, in the words of Lopes, "if I do not fit in with his culture and his methodology and agree with him 150% all the way in connection with the branding and everything he does, I can pack my stuff and leave immediately." After the third visit by Levenstein, Lurie telephoned Lopes and said: "You are supposed to be working on the annual report, why are you upsetting Jeff? Why do you not support Jeff 150%?". Lopes then resigned.

89.2 On 21 August 2000 Lurie informed Martin that Lopes had been dismissed by Levenstein on 18 August 2000 and Lurie and Levenstein sent Martin a document prepared by Radus. Altogether about twenty-nine specific allegations of misconduct were levelled against Lopes, including sexual harassment, taking kickbacks, unlawfully suppressing the share price, incompetency, dishonesty, lying, fraud and corruption: all allegations which pre-dated Lopes' visit to the Reserve Bank on 14 August 2000.

89.3 On 23 August 2000 Lurie told the BSD at a meeting between Regal and the BSD that Lopes "had not applied his mind" in regard to the financial statements. No other allegations of misconduct were made.

89.4 On 7 September 2000, Jonathan Myers, representing Regal, replied to a letter of Michael Krawitz of 5 September 2000 in which he alleged that, *inter alia*, Lopes had unlawfully suppressed or caused a reduction of the share price of Regal Holding's shares on the JSE and that Regal Bank or Holdings was quantifying its damages in order to sue Lopes.

89.5 Lopes described what happened to him after he resigned. Initially, he was merely telephoned and told to return to the bank a computer he had at home. He then received a telephone call in late September 2000 from Jonathan Myers, representing Regal Bank, in which Myers said that if Lopes would sign a letter supporting Levenstein, describing him as a good CEO, and confirming that he had not been to the Reserve Bank, Regal Bank would not proceed with various criminal charges which the bank had laid against Lopes. The charges which were mentioned by Myers included fraud. Lopes refused to agree to the blackmail. Lopes denied the various allegations of misconduct. The only one he admitted was that he had stated in the application for a bank licence that he had a B. Com. degree. He admitted that he did not have a degree, but said that Levenstein was aware that he had no degree. In fact, it was at Levenstein's suggestion that instead of describing the degree as "uncompleted", Levenstein insisted that the word "uncompleted" be removed. One night Lopes was arrested at home at 21:30. The police said that fraud charges had been laid against him by Levenstein and he was accused of having two passports. The accusation was that he was about to leave the country. Lopes spent the night in gaol and was released on bail only the next day after counsel threatened to bring an application in the High Court for bail. Bail was set at R10 000. The criminal charges were of fraud. Lopes appeared in court four times. He never received a charge sheet and eventually the charges were withdrawn against him. During the period from his resignation until the charges were withdrawn, Lopes and his wife received many telephone calls. At one stage he received forty-six calls on his answering machine, a minute apart. "We did not answer any of them. There was nobody on the other side".

89.6 At a meeting of the board of directors on 31 January 2001 Levenstein informed the board that the criminal charges against Lopes had been withdrawn and that the matter settled out of court. The litigation with Lopes (and Steen) cost the bank R232 550.50 in legal costs.

89.7 Levenstein's evidence was that Lopes resigned on 18 August 2000. The evidence was in conflict with the letter Lurie sent to the BSD on 21 August 2000 in which he alleged: "On 18 August the CEO terminated services of Mr BK Levenstein ("BKL") and Mr JR Lopes. … On the same date Mr JR Lopes resigned from the board of the bank and Regal Treasury Bank Holdings Limited." At first Levenstein was adamant that the letter was wrong. He did not dismiss Lopes. In the DT s7 report, however, Schipper recorded that Levenstein had told him that he had fired Lopes. Levenstein again denied in evidence that he dismissed had Lopes. Levenstein then changed tack and testified that the allegation of a dismissal was "tactically to minimise the misinformation … It could have been tactical … When a bank fails, people commit suicide, people have heart attacks etc … A tactical theme would have been conveyed to [Lurie] … I probably … Conveyed to Jack Lurie in order to minimise the threat against the bank". At the Regal Bank board meeting on 25 October 2000 it was minuted that Lopes was fired as a staff member. Levenstein said that: "It would have been the information I conveyed to the board … A white lie … to protect the bank … With a man going out into the market place literally bring a bank to its knees, which to me is an act of treason and terrorism, to bring a South African institution to its knees … I believe that it calls for unusual action in the way as President Bush has to respond to the status quo …".

90

90.1 On 28 August 2000 Schipper of DT met with Lurie to discuss the terms of reference of the s7 review. Lurie welcomed the review, as did Levenstein, with whom Schipper met later that day. The work of DT commenced on that day.

90.2 On the same day that Lurie and Levenstein were pledging their support for the DT review, Radus signed a letter to the Registrar on behalf of the executives of Regal Bank. The letter placed on record the "total support" of the executives for Levenstein, alleged that the DT appointment was unfounded and totally unnecessary, that Levenstein's "integrity and track record … speaks for itself" and ended by calling upon the Registrar "to support and stand behind" Levenstein. In his evidence, Radus at first said that Levenstein drafted the letter and he, Radus, signed it. Later in his evidence Radus said that he might have done a draft and Levenstein changed it "… Or he did the letter. I cannot remember. Really. It is certainly not my language, that is all I can tell you. But I did agree with this and the executives agreed with this." Asked who the other executives were on whose behalf he wrote the letter, Radus said that the only other executive was Diesel. Later on in his evidence, Radus again said that he could not remember who the author of the letter was, but is was written at Levenstein's initiative.

90.3 On 30 August 2000, while the s7 review was in progress, the boards of Regal Holdings and Regal Bank met. The audit committee met on 4 September 2000. The s7 review was not discussed at all.

90.4 On 25 October 2000, two days after the meeting between the BSD and directors of Regal Bank, there was no mention, let alone discussion, of the meeting with the BSD and the s7 report at the meeting of the board of directors of Regal Bank, the meeting of the board of directors of Regal Holdings, or the annual general meeting of Regal Holdings.

90.5 Lurie was questioned about why the boards of directors did not discuss the DT s7 review at all in the meetings held at the time. He had no acceptable explanation. According to him, Davis was instructed to deal with the various issues raised in the report. He assumed that because most of the directors had attended the meeting with the BSD on 23 October, “there was no necessity to rehash it”.

91

91.1 Between 1 July 2000 and 17 November 2000, Levenstein negotiated various agreements with Mettle. The focus for the moment is on the corporate governance aspects of the Mettle transactions as corporate governance was the focus of the DT s7 report. To emphasise the importance of the Mettle deals to Holdings, the contribution of *all* the Mettle transactions was to purport to increase the assets and liabilities on the balance sheet from ±R1bn to ±R1.6bn.

91.2 The Mettle transactions should have been debated and agreed to by the board of directors for these reasons:

- the transactions reflected a change in strategic shift;
- the large total size of the transactions in relation to the total assets and liabilities of Holdings;
- the exposure to one counter party, Mettle Ltd, or its SPV’s.

Yet the minutes of the meetings of the board meetings show that the transactions were *never* discussed by the directors. The evidence of the directors on the Mettle deals is analysed in detail in Part Three. For present purposes, it is sufficient to refer to the following:-

- Levenstein said that he would have discussed the “broad architecture” of the Mettle deals with Exco, because the deals were difficult to understand and very complex. His evidence on whether the Mettle deals were ever discussed with the boards of Regal Holdings and the bank was contradictory. While contending that there was no requirement for him to discuss the deals with the boards, as these were "operational issues", he said that it was in any event impossible to explain the deals: "you needed a mathematical background, you needed an understanding of derivatives, arbitrage activities, etc".

- Lurie said that the Mettle deals were discussed "at length at board room level". He believed that the deals "were so intricate and so involved that a lot of them did not really understand what this was about". Lurie did not know the details and extent of the Mettle transactions. The deals were "highly complex" and not in his "field of expertise".
- Diesel's evidence was that the Mettle deals were all done by Levenstein. There was no prior discussion of any of the transactions. The first time Diesel would become aware of a "structured deal was when in all instances I was given handwritten instructions outlining the transaction".
- Buch said that he was not too involved with the Mettle deals. He had an understanding of the RMI and 93 Grayston structures. He relied on the auditors.

- Radus said he never saw the Mettle agreements. He had a vague idea about some of the transactions. In regard to one transaction, Levenstein told him: "I would not understand the intricacies of the financials".

92

92.1 Pekane Investments (Pty) Ltd ("Pekane") was the registered holder of 15.5m shares in Regal Holdings. Pekane was a subsidiary of Worldwide. On 29 December 2000 Regal Bank paid Worldwide R60m for those shares. Precisely why it did so was a matter of lengthy debate and confusing evidence at the commission. On a reading of documents produced by Nhleko, however, the matter is quite simple. Regal Bank bought the shares from Worldwide on 12 December 2000 at a price of R3.90 a share. A term of the agreement was that delivery of the shares would take place on 29 December 2000 against payment of the total price.

92.2 The Pekane transaction is analysed in Part Three and dealt with later in Part Two in relation to the 2001 audit. All that needs to be said about it to close off the discussion on the 2000 year is that the true nature of the transaction was not shown in the records of Regal Bank. Levenstein did not want it to be known that the bank had acquired, and therefore owned, 15% of Regal Holdings shares (in addition to the 15% of Holdings shares held by the two trusts). The transaction, accordingly, was reflected as follows:-

- In the draft statutory financial statement of Holdings, Pekane was shown as a major shareholder of 15.5m shares, representing 15% of Regal Holdings shares. The financial statements were approved by the board of directors.
- The payment of R60m was shown as an overnight loan to "Phekani Investments" secured by shares with a market value of approximately R70m.
- Diesel's evidence was that he was informed by Levenstein in December 2000 that Pekane had offered the Regal shares for repurchase in terms of the original sale agreement. The price was below the current market price. Diesel, as treasurer, was asked by Levenstein to ensure that there was R60m cash available to pay the price. On returning from leave in early January 2001 Diesel noticed that a loan had been created in the name of Pekane. Levenstein told Diesel to leave the loan in place as a sale of the shares to a third party was imminent.

<u>2001</u>

93

93.1 The year 2001 commenced on a positive note. The corporate governance concerns of the BSD were addressed, albeit too late to save the bank.

93.2 Cohen, formerly of Mercantile Bank and SASFIN, was approached by Levenstein and Rabins in about mid-October 2000 to identify weaknesses in the bank and to produce a plan to rectify the weaknesses. He commenced in about mid-November 2000 as a part-time consultant. He worked his way through the DT <u>s7</u> report. Cohen's initial findings and recommendations were, inter alia:

- the whole issue of corporate governance had to be looked at expeditiously;
- to appoint more bankers to the boards of directors;
- to write charters for the committees of the board;
- to introduce staff policies, a matter on which Van der Walt was working at the time;
- to address the lack of succession planning;
- to remunerate non-executive directors properly;
- to introduce an effective internal audit function.

93.3 During the course of 2001 Cohen was appointed a director of both Regal Holdings and Regal Bank, officially from 28 March, but practically from January. He became chairman of Regal Holdings on 28 March, chairman of Regal Bank on 1 May, chairman of the risk management, credit, and HR committees and was a member of the corporate governance committee. He served as chairman of the audit committee until he became chairman of the bank.

93.4 Cohen arranged for the appointment of Oosthuizen, a former Deputy-Registrar of Bank, and Scheepers, formerly of PWC, as directors. Oosthuizen became chairman of the corporate governance committee. Scheepers became chairman of the audit committee after Cohen.

93.5 During late 2000 and early 2001 a number of improvements were made: charters for the committees were prepared; the taking of minutes was outsourced; the human resources function was assumed by a division of DT; PWC became internal auditors; a financial director, Zarca, was appointed with effect from 1 July; and Taylor was appointed compliance officer.

93.6 With effect from 18 June 2001, Robinson, formerly of Absa Bank Limited, became CEO.

93.7 Had those changes been made six months earlier, Regal Bank would still be in business and depositors' money would not be at risk.

94

94.1 A nail in the coffin for Regal Bank was the notification by EY to the Reserve Bank on 25 June 2001 that it intended to withdraw its consent to the preliminary results of Holdings for 2001 ("the 2001 preliminary results"). The story of how that came about, after EY had originally approved the preliminary results, is now told.

94.2 EY audited Regal Holdings, Regal Bank, the Incentive Trust and the Shareholders Trust for 2001. The audits of the trusts were conducted for the first time.

94.3 In their working papers of 29 November 2000 EY identified as "internal control considerations" the 2000 branding dispute between the bank and EY which "brought into question the integrity of management". The dominance of Levenstein introduced the risk that "management override may occur … negating the effect of the internal controls". The risk of fraud was said to be "quite high".

94.4 On 30 November 2000 EY finalised its planning board report for submission to the audit committee. Overall materiality for the year ending 28 February 2001 was assessed to be R6m. A factor which was taken into account in arriving at that amount was "the higher risk associated with the loss of senior members of staff during the year". One of the risk areas referred to in the planning board report was “the recognition of income from Regal’s branding entities”.

94.5 On 8 December 2000 the audit committee approved the EY planning board report.

94.6 On 31 January 2001 the audit committee met. EY was present. The letter of engagement was handed to Cohen. The audit was to commence on 17 February 2001.

94.7 On 28 March 2001 the audit committee met. EY was present. EY tabled Appendix A, a document setting out issues identified by EY, the response of management, and the resolution of the issues. Appendix A was updated from time to time and presented to various audit committees thereafter.

94.8 On 12 April 2001 the draft financial statements were discussed at an audit committee meeting. Income before taxation was shown as R115.8m. EY required substantial adjustments to the figures presented.

94.9 On 25 April 2001 the profit announcement as tabled by management was approved by the audit committee. Income before taxation was R71.5m, a reduction of R44.3m from the R115.8m, after EY’s adjustments had been taken into account.

94.10 On 26 April 2001 Regal Holdings provided EY with a letter of representation. The letter was signed by Cohen as audit committee chairman and Levenstein as CEO. The letter contained a number of representations which were subsequently found to be false by EY.

94.11 The 2001 preliminary results were published on 30 April 2001 ("the 2001 preliminary results". At about the same time a presentation was made to analysts. The income before taxation was R71.5m (compared to R55.5m as at 28 February 2000).

94.12 At an audit committee meeting on 21 May 2001 EY reported that it would provide an unqualified audit report subject to the finalisation of a few outstanding issues.

94.13 Regal Holdings issued a second letter of representation on 13 June 2001, signed by Cohen only. Unlike in the first letter, the representations in this letter were qualified by the phrases: "to the best of our knowledge and belief" and "based on undertakings given by management".

94.14 An audit committee meeting took place on 21 May 2001. EY undertook to provide an unqualified audit report, subject to the finalisation of a few outstanding issues.

94.15 During the Investec due diligence, which is described later, on Saturday, 23 June 2001, Van der Walt mentioned four matters to Strydom of EY:

- the sale of 8m Regal Holdings shares to Mettle was not a true sale in that the "risk and reward" of the shares remained with Regal Bank;

- the purchase of Regal Holdings shares by the Incentive Trust and the Shareholders Trust was not good practice;
- Regal Holdings had bought the 15% shareholding of Worldwide through Pekane in terms of s38(2) of the Banks Act;
- After year-end, two bundles of R10m worth of preference shares had been bought by Mettle SPV's, but the effect of which was that the risk and reward remained with Regal Bank.

Strydom was so concerned at these disclosures that he requested the chairman of EY, Wixley, to join him. On the Sunday, Hourquebie, the CEO of EY, joined Wixley and Strydom at the bank. EY attended the board meeting that night.

94.16 On Monday, 25 June 2001, Strydom met with the BSD. EY withdrew its consent for the publication of the audited financial results. The reasons were contained in the letter EY sent to Regal Holdings on 9 July:

"It appears that certain information was withheld from us during the course of our audit and that certain representations made to us were untrue. …

Without limiting the extent of our re-assessment, we specifically refer to:

- A number of structured transactions in which the ultimate effect of the transactions might be different from that presented to us.

- Regal Bank financing the purchase of some 45% of the shares of Regal Holdings. We believe that it might be difficult to demonstrate that each of these advances were given “in the ordinary course of business” in terms of Section 38 of the Companies Act … Regal Bank might also be in contravention of Sections 37, 38 or 78 of the Banks Act regarding the funded shares …
- The possibility that one or more material irregularities and/or undesirable practices may have been committed which required to be reported by us under the Public Accountant and Auditors Act and the Banks Act, respectively.”

95 The misrepresentations made by Regal Holdings to EY during the 2001 audit were the following:-

95.1 Holdings represented to EY that Pekane was the holder of 15.5m shares in Regal Holdings and that the bank had lent Pekane R60m. The representations were false in that Regal Bank had bought those shares from Pekane for R60m:-

95.1.1 EY knew that Pekane was the registered holder of 15.5m shares in Regal Holdings. In the draft financial statements for 2001, approved by the board of directors, in the “analysis of share register” Pekane was reflected as a major shareholder of 15.5m shares, representing 15% of Regal Holdings shares.

95.1.2 The facts as disclosed to EY at the time of the audit were the following:

- EY requested Regal Bank to furnish information on, and the recoverability of, “Phekani Investments (overnight loans) R60.2m”. On 12 March 2001 Cohen gave EY this response, prepared by Davis: “Phekani – this is secured by shares with a market value of approximately R70m.” EY thereafter recorded the transaction in a schedule of overnight loans with Treasury in these terms:

  “Phekani Inv: on loan: R67 400 805: This secured by shares with a market value of approximately R70m”.

- Strydom’s evidence was that he did not make the connection between Phekani Investments and Pekane, the investment arm of Worldwide.

- At a board meeting of Regal Holdings on 31 January 2001 Levenstein reported that “the return of the Worldwide shares would create an opportunity to distribute smaller parcels in blocks of perhaps 50 000 to loyal Regal supporters at a small discount to the market price …”. Strydom understood from that minute that “Regal was placing the shares … being a conduit” and was not a buyer of the shares.

95.1.3 Prior to 23 June 2001 EY was not aware that Regal Bank had bought the Pekane shares in December 2000 and had paid R60m for the shares on 29 December 2000.

95.1.4 Strydom testified that if he had been told the truth during the audit process he would have reported the matter to the BSD because, in effect, Regal Bank would have owned 30% of Regal Holdings shares and that was not good business practice. It was “a fairly incestuous investment”. He would have ensured that any interest that Regal Bank earned on the loan to Pekane would not be recognised as income in the financial statements of Regal Bank as it would have been “income earned in effect from yourself”.

95.2 Holdings represented to EY that Mettle had bought 8m Holdings shares from the Shareholders Trust in an arms length transaction. The representation was false in that the risk and reward remained mainly with Holdings and the bank.

95.2.1 The knowledge that EY had prior to 23 June 2001 about the 8m Regal Holdings shares sold to Mettle was the following:

- In the DT s7 review of 31 October 2000 it was said that the loans of R36m to the

Shareholders Trust were secured by Regal Holdings shares worth R17.6m. No provision or adjustment was made by the bank for any potential write-off. The review continued: "The CEO and management are confident that there is no permanent diminution in the value of the shares and that no provision is necessary. He also informed us that a substantial number of shares will be placed with a new shareholder at a price of between R5 and R6 per share."

- EY was informed by the bank that 8m Regal Holdings shares had been sold to Mettle during late 2000 for R5.50 per share, a premium of about R1 per share. EY assumed that that was the transaction that is referred to in the DT s7 review. EY was assured that it was an out-and-out sale.
- In Appendix A, which was tabled at various audit committee meetings, this was noted:

  "5. Sale of 8m Regal Shares at R5.50 by the Shareholders Trust to Mettle:

  Bank Supervision informed us that Mettle indicated in an article in the Financial Mail of 1

December 2000 that they did not have a stake in Regal and pointed out that the sale was merely a security provided by Regal for the back leg of a structured finance transaction."

- In the first letter of representation dated 26 April 2001 Regal Holdings made the following representation:

  "That the sale of 8 million Regal shares at R5.50 by the Shareholders Trust to Mettle was unconditional and that the shares are registered in Mettle's or its nominee's name".

- In the second letter of representation the same representation was made but preceded by the words: "based on representations by management".

- The 2001 preliminary results reflected Mettle Securities Ltd as the owner of 8 million shares.

- On 11 May 2001 EY sent an e-mail to Davis in which Davis was asked, in regard to the 8 million shares sold to Mettle: "Was this transaction part of the normal operations of the trust i.e. placing shares in strong hands, or was it part of one of the structured deals with Mettle?

If it was part of the structured deals, which one was it part of?” The answer given by Davis was: “The transaction was simply a means of achieving the objectives of the trust, i.e. moving shares from weak to strong hands. I think SARB’s concern arises from an FM article, where Hein Prinsloo of Mettle was misquoted.” Davis said that he obtained that information from Levenstein.

- At an audit committee meeting held on 28 March 2001 it was minuted that the 8m shares sold by the Shareholders Trust to Mettle were unconditionally registered in Mettle’s name.
- In dealing with the BSD queries arising from the DT s7 review, EY on 14 May 2001 accepted Regal Bank’s representations: “The Mettle transaction forms part of the normal operations of the Rand Shareholders Trust i.e. ‘to allocate shares from weak hands into strong hands’”.

95.2.2 On an analysis of all the Metshelf 1 contracts concluded on 22 October 2000, Strydom came to the view, which is correct, that the risk and reward in respect of the 8m shares remained with Regal Bank.

95.3

95.3.1 Van der Walt told Strydom on 23 June 2001 about two lots of R10m that Regal Bank put in a structure to finance the purchase of Regal Holdings shares after the year-end. Strydom subsequently identified the structures at Metshelf 2 and 3. Van der Walt told Strydom that the structures were normal in the market place and there was nothing illegal about them.

95.3.2 Strydom, however, was concerned that the transactions were not good banking. Taking into account the other transactions that Van der Walt described to him, Strydom came to the view that Regal Bank in effect owned 45% of Regal Holdings shares.

96 EY's concern was that if the 45% shareholding was cancelled, the share capital and reserves of approximately R441m would be reduced below the required R250m share capital. If the Mettle structures were not cancelled, on the calculations EY did, Regal Bank would move to a capital adequacy below the required 8%.

97

97.1 EY concurred with the recognition of branding income in the 2001 preliminary results in the sum of R24m, made up as follows:

Regal Protea Health	R1 m
Medsurg	R2.5m
RMI	R21.5m
	R24m

97.2 The amount of R21.5m was the difference between the sale price of R26m and the amount of R5.5m recognised in the 2000 financial year.

97.3 EY set off the amount of R21.5m against an amount of ±R20m in respect of a royalty agreement which it regarded as an onerous contract.

97.4 At the time of the audit EY was not shown three of the agreements which made up the RMI structured finance deal: the preference share agreement, the security deposit agreement and the pledge and cession of securities. Had EY been shown those agreements, it would not have regarded the sale as an actual or real sale and it would have reversed the income of R21.5m and reduced the profit by R26m.

98

98.1 EY concurred with the recognition of income of R5.9m earned on the preference shares of R150m in respect of the Kgoro deal.

98.2 Fundamental to the recognition of the interest was proof that a deposit had been made. Regal Bank contended that Mettle had made the deposit. In a board report submitted to the audit committee, EY called for confirmation from Mettle "as to the existence of a R150m deposit held by them with Regal". As at the end of April EY had not received confirmation but assumed that the deposit had been made as it was "the opposite side of the R153m preference share investment. … At no time when we discussed confirming the deposit (with Mettle) with the audit committee or Jonathan Davis have they denied that it is a deposit". On about 27 May 2001 EY contacted Mettle and requested confirmation. Confirmation has never been received.

98.3 What EY did not know was that the preference share agreement was part of a structured finance deal. EY did not have knowledge of the sale agreement and the call option agreement.

98.4 Had EY known the true facts, they would have realised that a deposit of R150m had not been made and they would not have recognised the income of R5.9m as there was no true sale.

99

99.1 EY concurred with the recognition of a dividend of R5.2m on an investment of R125.5m in Metshelf 106 preference shares.

99.2 Unknown to EY, the underlying portfolio consisted of Regal Holdings shares. Had EY known the true facts, they would not have recognised the income.

100

100.1 Regal Bank wanted EY to agree to the recognition of R185m in respect of the forward sale contract of 93 Grayston Drive. The amount was "based on a R600 million maturity value and yield of 12.47%, the amortised value of the forward sale contract of 93 Grayston Drive is approximately R185,261,126.00".

100.2 EY informed the audit committee on 28 March 2001 that they required a valuation of the immovable property from an independent valuator.

100.3 EY was aware of the sale of property and addendum but was unaware of the existence of the preference share agreement, the put option agreement and the call option agreement.

100.4 Regal Bank obtained a valuation from a valuer, De Vos, who placed a value of R144m on the property. One of the assumptions he made was that the property would be fully let. EY accepted the valuation.

100.5 In the board report EY recognised "other income" of R88m. That amount included R36.5m as "revaluation on 93 Grayston Drive".

100.6 In the summary of audit differences it was said that the following items had not been adjusted for and included:

	Balance Sheet	Income Statement
Onerous contract – no provision made	(20,463,573)	20,463,573
Over accrual for valuation of Regal Protea Health	(600,000)	600,000
Under accrual for revaluation of property	17,500,000	(17,500,000)
Net Effect:	**(3,563,573)**	**3,563,573**

100.7 The total of the amounts of R36.5m and R17.5m, R54m, was arrived at by deducting the cost of development of 93 Grayston (R90m) from the De Vos valuation (R144m). R36.5m of the R54m was appropriated to "other income" and R17.5m was set off against the onerous contract and the over accrual for the revaluation of Regal Protea Health. Strydom conceded that, but for the onerous RMI contract, EY would have recognised another R17.5m in "other income". The set-off was a compromise between Regal Holdings and EY.

100.8 It follows that 93 Grayston contributed 41.4% of "other income" if R36.5m is recognised (and 62.5% if R54m had been recognised).

100.9 Taking into account the true nature of the 93 Grayston structured finance deal, EY would still have permitted the recognition of the R54m but under another caption. In the income statement the R54m would not have been shown as "profit on financial instruments" but rather as "revaluation of investment property".

In the profit announcement "financial instruments" were shown to constitute 41.46% of "non-interest income" of R88m.

100.10 Analysts would regard profit on financial instruments as more significant for a bank than a revaluation of immovable property.

101

101.1 The impact on the preliminary financial results for 2001 if the EY adjustments were made is that the profit of R71.5m would have been reduced by the following adjustments:

	Rm
RMI: sale proceeds	20,5
RMI: 2000 valuation	5,5
RMI: Fee from Elul	2,7
Kgoro:	5,9
Metshelf:	5,2
Protea Health	,6
Interest reversed Pekane "loan"	1,2
	41,6

The profit of R71.5m, reduced by R41.6m, would have been R29.9m. But for the profit of R36.5m disclosed on 93 Grayston, the bank would have made a loss.

101.2 This does not take into account:

- potential losses on advances to employees and directors totalling R34.8m (130119) to buy Holdings shares;

- the debits of R20m and R6m referred to in §86 and §51.26 of Part Three.

102

102.1 A major respect in which the 2001 preliminary results were misleading was the inclusion of the Mettle transactions in the assets and liabilities. Unaudited entries in the general ledger disclosed that as at 26 June 2001 the contribution of the various transactions was as follows:-

Date of transactions	**Transactions: number and name**	**Resulting assets Rm**	**Resulting liabilities Rm**
February/March 1999	(2) Tradequick & RVM	211	212
30 August 2000	(1) Regal Securities	106	98
July/August 2000	(1) RMI	25	2
11 October 2000	(1) Kgoro	164	150
17 November 2000 30 August 2000	(2) 93 Grayston & Stone Manor	Not implemented	Not implemented
27 Oct 2000 / 14 March and 6 April 2000	(3) Metshelf	145	85
	10	**651**	**547**

102.2 The increase in assets and liabilities would have been important for Regal Bank as a sign of healthy growth and possible gain in market share and might have had a positive impact on the share price.

102.3 Levenstein was interviewed on radio by Moneyweb on 30 April 2001, the day the preliminary results were released. He was asked how Regal Holdings had achieved a growth in total assets from R998m to R1.6bn. In his reply, Levenstein referred to anything but the Mettle deals. When asked to whom he was lending the money, Levenstein replied: "The crème de la crème of the professional market, by reference of course to Wingate and the accountancy market, knowledge to the people and high net worth individuals."

102.4 The truth, which Levenstein did not disclose, was that it was the Mettle deals that accounted for the "growth". In reality, there was no growth. As Prinsloo of Mettle explained: most of the structures "should have been treated from an accounting point of view with set-off. In other words, I have got my asset – my preferent share and I have my corresponding liability that secures that asset. So it should not grow your asset in your liability book, it should not … You cannot show it as gross assets and gross liabilities".

102.5 Had the Mettle deals been excluded, the total assets would not have increased as dramatically.

103 In the result, the 2001 preliminary results were inaccurate in a number of material respects. The fault lay at the door of Regal Holdings, Levenstein and EY.

104 Regal Holdings was at fault for not making full and accurate disclosure of all material information to its auditors.

105 Levenstein was at fault as CEO of Holdings for not ensuring that Holdings furnished all relevant information to EY and for not disclosing all the Mettle transactions to the boards of Holdings and the bank, to management and to EY.

106 EY was at fault in two material respects:

106.1

106.1.1 EY's knowledge at the time of the 2001 audit about Pekane, in essence, was that Pekane, a subsidiary of Worldwide, was the registered holder of 15.5m shares in Regal Holdings and that there was an overnight loan of R60.2m to "Phekani Investments", secured by shares with a market value of approximately R70m.

106.1.2 Strydom said that he did not make the connection between "Phekani Investments" and "Pekane" until after the profit announcement. He was not aware that the security of shares of R70m was not investigated by EY. It was only on 23 June 2001 that he became aware that the shares were Regal Holdings shares. When pertinently asked: "Should Ernest & Young not have investigated what the security was and what its value was?", Strydom replied: "Yes … probably I think that Ernest & Young accepted the representation from Regal management too easily on that one". Strydom conceded that the "overnight loan" of R60m was a "very large exposure".

106.1.3 EY did not ask to see the alleged loan agreement, the alleged agreement of security, and what shares had been provided for security. They should have done so. They had been placed on their guard in the previous year in regard to the branding dispute and the publication of the financial results on 16 May 2000. This was not a client that deserved trust. Had EY made enquiries of the kind required, they would have realised that Regal Bank had bought Regal Holdings shares for R60m and that Worldwide was no longer a shareholder.

106.2

106.2.1 At the meeting between BSD and EY on 12 February 2001, Martin emphasised that the main focus of the audit for the 2001 year would be the DT s7 review. A number of issues raised in the s7 review were dealt with in the meeting. Relevant for present purposes is that the relationship between Regal Bank and Mettle was canvassed in various respects. EY was specifically instructed:

- "To review the transaction between Mettle Ltd and the trust …
- the rationale of the Mettle transaction;
- to review involvement of Mettle Ltd in the branding strategy;
- to review contractual and legal relationships between the bank and Mettle Ltd with regard to various transactions;
- to review the shares purchased off the market price;
- to determine the need for specific provisions;
- if the accounting treatment of this transaction was incorrect, Ernst & Young should disclose how it should be correctly reported." It was minuted that Strydom said he would "visit Mettle to get the whole picture of the transaction and clarification on related issues before he could draw a conclusion on the Mettle transaction …" .

106.2.2 At the audit committee meeting on 12 April 2001, the draft audited financial statements were tabled. It was minuted that "Ernst & Young requested more time to finalise the accounts and to clear outstanding issues … The proposed dates for the release and publication of the results was 2 May, but not later than

3 May … In view of this deadline, it was agreed that management and the auditors would expedite all unresolved matters that could delay the finalisation of the accounts." It was further agreed, according to the minutes, "that all outstanding issues pertaining to corporate governance, regulatory compliance and internal controls be dealt with as a matter of urgency by management in consultation with the internal and external auditors".

106.2.3 Cohen testified that included in the matters which EY and management were required to resolve were the R150m deposit from Mettle and that the 8m shares had been sold to Mettle.

106.2.4 At the audit committee meeting on 25 April 2001 the group and bank audited financial statements as tabled by EY were approved, subject to minor adjustments. According to Cohen, that meant that the outstanding issues had been dealt with by management and EY.

106.2.5 The evidence of Prinsloo of Mettle was that a meeting was arranged with EY somewhere in April or May 2001, which was cancelled by Levenstein. Prinsloo said that if EY had telephoned Mettle, EY could have "got all the contracts in one file. And

> when anyone looks objectively at the preference share agreements, one should ask whether the Mettle SPV's had any balance sheet? No. What is my security? It is an NCD from Regal. Simple, so you cannot show the two separate. Just a few questions would have showed that … If you know they have invested in a preference share, that is it. It is just the logical next question … What is my security".

106.2.6 Strydom's explanation for not seeing Mettle before 30 April 2001 (the date of the publication of the 2001 preliminary results) was that it was not normal for an auditor to visit the suppliers of a bank and initially EY thought the documentation given to them by the bank was sufficient. After the publication of the interim results, it became clear that certain information was not true, that made EY suspicious and hence their insistence on seeing Mettle. The meetings that were arranged were cancelled and EY "had to insist that they be reinstated" .

When it was put to Strydom that he had told the BSD on 12 February 2001 that he would visit Mettle, Strydom said that "we thought the easiest way was to see Mettle … Later on [we] decided that we had received the full picture”.

106.2.7 EY cannot hide behind the non-disclosure of the Mettle deals by Levenstein and Holdings:-

- The BSD had pertinently instructed EY to investigate the Mettle deals.
- The Mettle deals were significant for Holdings and the bank: assets and liabilities had been increased by ±R600m from R1bn to R1.6bn.
- EY knew that Holdings and Levenstein could not be trusted. In its own working papers of 29 November 2000 the integrity of management was brought into question and the risk of the fraud was said to be quite high.
- EY had said at the meeting with the BSD on 12 February 2001 that they would meet with Mettle, long before the publication of the results on 30 April 2001.

107 A further disturbing feature of the way Regal Bank conducted its business is the inaccuracy of the DI returns which it submitted to the Reserve Bank:-

- Strydom handed in a comparison of the DI510 returns as submitted by Regal Bank in March 2001 and after a revised audit had been done by EY in June. In March the large exposures were shown as:

	000
Phekani Investments	66 862
Incentive Trust	68 295
BOE	303 000
TOTAL	438 157

  On the face of it the BOE transaction was an inter-bank transaction and did not attract a capital requirement.

- Once the truth was established that the exposure was not to a bank, BOE, but to Mettle and its SPV's, the capital requirement on those transactions increased substantially.
- The impact of the accurate reflection of the Mettle deals is clearly shown in a comparison between the March and June 2001 DI 400 returns (180269), in which capital is calculated:

	March	20%
DI 100		501 487
	June	
DI 100		34 404

- Another misrepresentation in the March DI 100 return was that the amount of R192.4m was shown in the 50% category on the basis that that was the sum of the loans secured by mortgages on residential properties. The bank was not able to provide EY with any of the mortgage bonds. As a consequence, EY regarded those loans as unsecured and placed them in the 100% category.

- A further consequence of falsely disclosing the Mettle transactions as transactions with a bank, is that Regal Bank should have held R27.6m worth of liquid assets with the Reserve Bank, whereas in reality it held only R13.9m.

108 On 25 April 2001 the HR committee, chaired by Cohen, approved the payment of bonuses to executive directors and Exco members in the sum of R1.2m and to employees in the sum of R1m. Levenstein's bonus was R460 000. Levenstein overruled the HR committee and reduced the amount to be paid to employees to R400 000. It follows that Levenstein alone was paid a greater bonus than all the employees. This is another example of Levenstein's even-handed approach to remuneration and fine sense of sound corporate governance.

109 The event which triggered a loss of confidence in Regal Bank resulting in a run on the bank was the publication on 25 May 2001 of an article "Betting on a Brand" in the Financial Mail ("FM"). The author pointed out that banks like Regal are "exposed to the confidence game – they rely on spotless records and careful transparency to attract the public's money". The author had carefully analysed the court papers in the voluntary liquidation application by RMI which Regal Bank had successfully opposed. An interview was held with Levenstein. The article was negative. It concluded with quoting Levenstein saying that the R10m – R13m branding model he had "brought to the income statement" was a

"big achievement". "But", said the article, "some shareholders, at least, will be less than impressed with the short lifetime of the model and the fortunes it has delivered."

110 On 29 May 2001 Cohen received an advanced copy of an article which was due to appear in the FM on 1 June 2001. Levenstein explained to Cohen that Mettle had "full discretion to buy and sell shares in the portfolio where preferent share returns are linked to portfolio performance". He denied that Regal had any influence over the purchase of the shares. Cohen discussed the matter with Martin of the BSD and informed him that a joint meeting of the boards of directors had been called for the next day. The liquidity level on 29 May 2001 was R107m.

111 On 30 May 2001 the boards of Holdings and the bank met to discuss the FM article and the issues raised in it, especially the litigation with RMI. Diesel reported that "Treasury is down R22m – R25m on the week to date in response to the negative publicity". Cohen emphasised the need to monitor liquidity on a minute-by-minute basis and to report any negative trends.

112 On 1 June 2001 the article appeared in the FM with a headline, "Surprising surge in price: Mettle rides to the rescue". In the opening paragraphs it was stated: "After last week's Cover Story, which brought to

light the chaos in small bank Regal Treasury's branding income stream, readers may have been surprise to see the share price appreciate 7%.

Mettle Securities snapped up the vast majority of shares for sale since Thursday last week. A number of sources say Mettle got its hands on more than seven thousand shares, worth about R3.8m, on Thursday, Friday, and this Monday. Close to 1m changed hands – a third of the average for an entire month. This Tuesday, though, Mettle seems to have turned seller again."

113 On 5 June 2001 the liquidity level of Regal Bank was down to R98.8m.

114 On 8 June 2001 a pipe bomb was found at the offices of Polaris Shipping next door to SASFIN. On the following day, 9 June 2001, a fire caused damage to the Polaris Shipping premises. On the evidence presented to it, the commission is unable to make any findings on the probabilities of whether those attacks were destined for SASFIN and orchestrated by Regal Bank. The evidence before the commission is analysed in detail in Part Three. The significance of the incidents is that the publicity which accompanied the incidents on 22 June 2001 must have contributed to the loss of confidence in the bank which culminated in curatorship four days later.

115 On 11 June 2001 the liquidity level was down to R70.3m. The bank experienced a "liquidity shortfall" which necessitated it using a marginal

lending facility of R18m at the Reserve Bank's money market department. The facility was repaid on 12 June 2001.

116 On 13 June 2001 a meeting of the joint boards took place. One of the issues discussed was that Regal Bank would enter into a preferent share agreement of R100m with Rand Merchant Bank ("RMB"). On the following day Cohen met with RMB to discuss such a transaction, in the words of Cohen, "to try and shore up the liquidity" of the bank.

117 On 18 June 2001 the bank, represented by Cohen, Lurie and Oosthuizen, met with the BSD represented, inter alia, by Wiese and Martin. One of the matters Cohen reported on was that he was not satisfied with the liquidity position of the bank and the steps he was taking to address the problem. The three directors of the bank expressed optimism about the future of the bank. Cohen asked the Registrar, so he testified, whether "Third tier liquidity provision would be available … Wiese replied in the negative because, unlike FBC Fidelity, the bank-client basis was in the high net worth market".

118 On the same day, Robinson commenced employment as CEO. His major concern was that there was no surplus liquidity. He commenced taking steps to arrange a credit line with other banks.

119 On 20 June 2001 Cohen was informed by Guard Risk that the underwriters were not committed to the RMB preferent share deal. Diesel reported to Cohen that the bank was "at the 75% limit on the statutory liquidity with the Reserve Bank".

120 On 21 June 2001 Cohen requested Oosthuizen to visit Martin at home to reopen the possibility with the Reserve Bank of a third tier liquidity facility. Oosthuizen did so. His overtures were rejected.

121 On Friday, 22 June 2001, Regal Holdings and Investec met. According to Robinson, the "ostensible purpose of the meeting was to create some standby credit lines in case of a liquidity run on the bank". The meeting concluded on the basis that Investec would conduct a due diligence over the weekend with a view to acquiring the bank.

122 On the same day, an article appeared in the Business Report, with the headline "Regal Treasury Bank employee arrested after bomb attacks". In the article it was alleged that the South African Police Services ("SAPS") had launched an investigation following the arrest of a Regal Bank employee who had been linked to an attempted bomb attack on business premises in Johannesburg; on 8 June 2001 a pipe bomb was thrown at office buildings in Waverley, but failed to detonate properly; on 9 June 2001, a petrol bomb was thrown in the same direction, causing a fire at an office owned by Polaris Shipping; Polaris Shipping

is adjacent to SASFIN Bank head office; one of the suspects was an employee of Regal Bank.

123 There was a hive of activity on Saturday, 23 June 2001. Investec commenced the due diligence. The Reserve Bank met with SASFIN and Regal Bank. Included in the Reserve Bank team were Ms Marcus, the Registrar and Martin. Included in the Regal team were Cohen, Lurie, Van der Walt, Scheepers and Oosthuizen. Robinson attended as CEO. Levenstein did not attend. At the Regal meeting, Cohen reported on a number of issues including corporate governance, the Mettle deals, death threats, the SASFIN bombing and the sale of Regal to Investec.

124 On Sunday, 24 June 2001, Investec completed its due diligence investigation. Investec decided not to buy Regal Bank. The Investec team had a number of major concerns with Regal Bank, including the financing by the bank of the acquisition of Holdings Shares, the Mettle deals, the development of 93 Grayston Drive, the R71m attributable income and the role played by Levenstein with “almost unfettered powers”.

125 A meeting of the joint boards took place on the night of 24 June 2001. Investec informed the meeting that it would not buy the bank but would buy R350m of the book debts for R305m. Strydom of EY expressed his

concerns about the 45% shares held indirectly by the bank and the financing of the acquisition of the shares by the bank. It was resolved that the following would be presented to the Reserve Bank the following morning for approval: "(a) Cancel 45% of shares – bring issued capital down to R200m; (b) J Levenstein announced retirement, with immediate effect; (c) Securitisation/sale of book to Investec – R300m within one week; (d) Ask the Reserve Bank to assist liquidity for one week." EY conveyed to the meeting that it would withdraw the auditors' statement "subject to opinion from H Vorster on treatment of dividends".

126 On Monday, 25 June 2001, the Reserve Bank, represented inter alia by Ms Marcus and the Registrar, met with EY and later with EY and Investec. At the first meeting, Strydom reported on what had transpired over the weekend and the resolution of the Holdings board the night before. At the second meeting, Investec informed the meeting of its offer. Strydom said that EY would withdraw their consent to the 2001 preliminary results published on 30 April 2001. A cautionary statement was drafted and issued to the public and to shareholders in these terms:

"Shareholders are advised that the Board of Directors of Regal have decided to undertake a significant restructure of the affairs of the company and of Regal Treasury Private Bank Limited ("Regal Bank").

The proposed restructure will, *inter alia*, involve the following:

1. The cancellation of approximately 45% of the ordinary shares of Regal in issue and held by certain trusts and other entities;

2. The restructure of the Board of Directors, it being advised the Mr Jeff Levenstein has tendered his resignation as a director of both Regal and Regal bank and will hold no further responsibilities;

3. A substantial portion of Regal Bank's advances book will be acquired by Invested Bank Limited;

4. An asset disposal programme will be undertaken over the forthcoming months.

Following the proposed restructure, the capital of Regal Bank will be comfortably above the minimum statutory requirement.

As a result of this proposed restructure, the auditors, Ernst & Young, have advised that they have withdrawn their consent to the publication of the preliminary audited results for the year ended 28 February 2001 which results were published on 30 April 2001. They have advised that in view of the proposals and new information that has come to their attention, they are required to perform further work before an audit opinion can be expressed on the annual financial statements of Regal for the year ended 28 February 2001." Moneyweb carried the story. Business Report reported on the SASFIN bombing. The share price slumped from 190c to 45c.

127 On Tuesday, 26 June 2001, there was media coverage in Business Day and Business Report. The Investec deal was announced. The Reserve Bank, including Ms Marcus and the Registrar, met with Store of DT. It was agreed to put the option of curatorship to Cohen. The

Reserve Bank and Store thereafter met with Cohen and Scheepers. Cohen told the meeting that the share price had "plunged" and that R250m had been withdrawn "following the announcement by Levenstein that he had not resigned but was away for a few days". Cohen applied for curatorship. Investec wrote a letter to the Registrar in which application was made in terms of s54 of the Banks Act for the transfer of a substantial portion of Regal Bank's advances book to Investec. The book would comprise loans, overdrafts, mortgage loans and instalment sale debtors. The Reserve Bank made application to the Minister of Finance for the appointment of Store as curator. The Minister agreed, with reservations. On the following day, curatorship was announced.