

Case Study:

Regal Treasury Private Bank Limited (“Regal”)

A. Background

- 1 In July 1991 Wingate Holdings Ltd (a small finance company) applied to the Registrar of Banks (“the Registrar”) to establish a bank. Wingate Holdings Limited (“Wingate”) was the holding company of Wingate Finance Limited. The application was unsuccessful. Mr Jeff Levenstein (“Levenstein”) was the person who acted on behalf of Wingate Holdings Ltd.
- 2 On 12 July 1995 Rand Treasury Ltd (“RTL”) was incorporated with Levenstein again as shareholder and chairman. On 17 August 1995 Levenstein became deputy chairman. On 2 October 1995 the directors agreed that application should be made for authorisation to establish a bank. The bank’s services would be offered to “a niche market of professionals and select net worth individuals”. On 1 March 1996 the Rand Treasury Shareholders Trust was created 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. Qualifications of directors who would play a prominent part in the affairs of the bank, were described in the application. 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 an income of R6.8m for the first year, with anticipated expenditures of R2.9m. On August 20 1996 the application for authorisation to establish a bank was granted. On 16 September 1996 RTL changed its name to Regal Treasury Private Bank Limited (“Regal Bank”). On 2 January 1997 a certificate to conduct business of a bank was issued to Regal.
- 4 As at 31 August 1997, the income of Regal was R5m, expenses R2.3m and share capital was R55m. During the last six months of 1997 signs of conflict between Mr Peter Springett (“Springett”), the chairman and Levenstein, the chief executive officer (“CEO”), emerged. Thereafter negotiations were in progress for the acquisition of a stockbroking firm. On 8 October 1997 Levenstein called a special meeting of the board to discuss his differences with the chairman and their apparent incompatibility. The latter was called upon to resign.
- 5 The financial results for 1 March 1997 to 27 February 1998 reflected a growth in share capital from R51.6m to R54.6 m, and profit after tax had grown to R8.3m. There were 500 shareholders.

- 6 In 1998 the chairman resigned and Levenstein took over the office, remaining on in the position of CEO. The reasons for Springett's resignation were various. Levenstein informed the Bank Supervision Department ("BSD") of the South African Reserve Bank ("SARB") that there was constant disagreement on strategic issues. Springett stated that Levenstein wanted to run the bank as a one man bank and that the majority of the board supported Levenstein. In Springett's words, it was a "classic case" of a lack of corporate governance leading to problems. The bank lost an independent chairman who understood and applied sound corporate governance principles.
- 7 On 18 February 1998 Levenstein met with the BSD. Disapproval was expressed with Levenstein's holding the office of chairman and CEO. After some further developments, the Registrar of Banks addressed a letter to Levenstein on 30 September 1998 giving notice that a suitable non-executive chairman should be appointed. Regal Treasury Bank Holdings Ltd ("Regal Holdings") later applied to register as a holding company. On 17 November 1998 the Registrar informed Levenstein that he could remain as chairman until the new Regal Holdings was listed.
- 8 On 7 July 1998 the Registrar granted an application for the allotment of 20% of the total share capital of Regal Bank to Worldwide Africa Investment Holdings Limited ("Worldwide"), however, on 15 December 1998 the Reserve Bank

informed Regal Bank 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.

- 9 The activities of the bank expanded. A stockbroking branch became operative on 2 March 1998. On 23 July 1998, the authorised share capital was doubled to 200 000 shares. On 5 November 1998, the BSD informed Regal 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 and in the course of the year a unit trust company was formed.
- 10 At the commencement of 1999, the board of directors of Regal Holdings consisted of six executive directors and eight non-executive directors.
- 11 On 17 November 1998 the Registrar gave the bank a period of grace until the listing of Regal Holdings to appoint a non-executive chairman but Levenstein remained in that position. On 10 May 1999 the Registrar informed Levenstein that reasons for not separating the offices of chairman and CEO were insufficient and a deadline by 31 July 1999 was set. On 19 July 1999 Levenstein responded that the deadline could not be reached. The Registrar then gave notice that separation had to be effected by 30 September 1999. On

29 September 1999 Mr Lurie, founding shareholder of Wingate and brother-in-law of Levenstein, was appointed as chairman.

- 12 During 1999 and 2000 Regal Bank's internal audit function was poor. After this continued for two years, PriceWaterhouseCoopers ("PwC") was appointed as internal auditors.
- 13 On 25 February 1999 Regal Holdings was listed. The share price eventually was R7.50, well below the expectations of employees and management, and in an attempt to boost the Holdings share price, the Shareholders Trust was used to buy Regal Holdings shares. Shares were bought by the trust to "channel shares into stronger hands". In 1999 the first Mettle Limited ("Mettle") transaction was concluded. It resulted in "back to back" preference share structures.
- 14 From what occurred during July 1999 it appears that the concept of corporate governance was foreign to Levenstein and the directors involved; that Levenstein was unfit as bank chairman or CEO; and that the directors, including non-executive directors, failed to act in accordance with their statutory duties and the recommendations of the King Report on Corporate Governance (King I).¹

¹ The King Report on Corporate Governance, 29 November 1994.

- 14.1 On 6 July 1999 Levenstein gave an instruction to the asset management division to stop “front running”, namely, to use Regal shares inappropriately, causing Regal shares to be pushed down artificially. There were other versions of the instruction, for example, that asset management was no longer allowed to sell any shares in Regal Holdings on behalf of any of its clients. Levenstein later appeared to be lying about this issue. Moreover, the Levenstein instruction was unlawful.
- 14.2 On 14 July 1999 Levenstein fired Mark Springett, a director of the asset management company, without a hearing. Accusations of breach of fiduciary duty and grossly subordinate behaviour made by Levenstein against Mark Springett were later found without substance. Levenstein furthermore accused Mark Springett of theft of millions of rand, fraud and theft of client’s money. The charges were never proved and were eventually abandoned.
- 14.3 Levenstein instituted civil proceedings against Mark Springett and others for return of their Regal Holdings shares. The civil action was later converted into an arbitration. The arbitration was eventually settled on the basis that the shares/proceeds could be retained. The proceedings cost the bank R806 945,69. Costly litigation was also pursued against others.
- 14.4 Levenstein succeeded in removing two other non-executive directors.

- 15 In September 1999 Levenstein nevertheless told the BSD that there was strong adherence to corporate governance in Regal Bank.
- 16 Regal Holdings results for the 6 months ended 31 August 1999 were published without the auditors' input and without the approval of the audit committee.
- 17 In December 1999 Levenstein told the directors of Holdings and the bank that he deserved a cash bonus of R2 million and a structural redesign of his restraint share allocation. He was paid the R2 million on 15 February 2000, but the requested 5 million shares were never issued to him. He nevertheless received R650 000 during 2000 as "dividends". The payment was described as "dividends" to avoid the payment of personal income tax. This additional remuneration was never authorised and at variance with Levenstein's policy on remuneration ("culture of sacrifice"). The "dividends" together with the payment of R2 million should have been disclosed as remuneration.
- 18 Early in 2000 the BSD conveyed concerns about corporate governance at Regal Bank to Ernst & Young and the bank. The BSD intimated that Levenstein was playing an over-dominant role. In February of that year the Registrar confirmed previous advice that new non-executive directors had to be appointed. The Registrar questioned the independence of the non-executive directors. He stressed that the BSD wanted to avoid a situation where the executive directors prescribed to the non-executive directors whereby the latter were not in a position to be totally independent. In April 2000 a meeting was

held to address the problem. Once again, however, Holdings and Regal Bank ignored the BSD. No independent chairman was appointed in 2000 nor were non-executive directors appointed.

- 19 Preliminary results for year-end 29 February 2000 were never published nor approved by the audit committee or the board of directors. In April 2000 highly disparate valuations for Kgoro and RMI were obtained. Ernst & Young threatened to qualify their report and an offer to resign was not taken up. Instead Levenstein informed to the Registrar that Ernst & Young struggled to blend former accounting standards with his own new highly complex banking model. Ernst & Young met with the Registrar and the latter informed Levenstein that if the 2000 financial statements were qualified by Ernst & Young, the Registrar would appoint an independent advisor (KPMG) in terms of section 7 of the Banks Act² to give another view, which the Registrar then did.
- 20 Before KPMG produced its report on 15 May 2000, Levenstein continued to make a case that Ernst & Young was wrong. In their report KPMG set out Levenstein's "branding concept" (boosting profits and balance sheet by booking income expected to be earned in future from companies in which investments were made) and measured it against AC000. The eventual finding was that branding income could not be measured in monetary terms with

² Act 94 of 1990 ("Banks Act").

sufficient reliability and that it was then also inappropriate to recognise any such income.

21 In May 2000, the Registrar held four meetings with the relevant parties. The Registrar later conceded that Levenstein's rejection of the opinions of Ernst & Young and KPMG and his intention to go ahead with publication of the audited results even if qualified (which would effectively have led to the closure of Regal Bank), was irrational and stubborn but that he lacked powers to do anything about it. With some changes the results of the audited statements for the year ended 29 February 2000, published on 16 May of that year, were not approved by Ernst & Young, the audit committee or the board. These results contained a number of material fraudulent misrepresentations. On 17 May 2000 Ernst & Young requested a correcting statement, and a retraction by Holdings was published on 19 May which satisfied Ernst & Young. These actions were hopelessly inadequate and Ernst & Young seemed to have been suffering from battle fatigue.

22 The statutory financial results were published in September 2000 but the results were never approved at any of the prior board meetings. The statements contained a host of misleading aspects. However Regal Holdings published unaudited results for the period ending 31 August 2000 on 5 September 2000, this time with the approval of the audit committee. Ernst & Young (for various reasons stated by Levenstein) were not invited to the above-mentioned

audit committee meeting, although their presence was necessary. The firm only attended one out of five meetings held in 2000. For various reasons, the failure to invite Ernst & Young to attend these meetings was egregious. More importantly if adjustments proposed by Ernst & Young had been made to the interim results of 31 August 2000, a nominal profit of R650 000 would have been shown instead of the stated profit of R49.5m.

- 23 On 14 August 2000 a director of Holdings and the bank, and the chief operating officer of the bank, met with the Registrar and made over 30 allegations of mismanagement. The Registrar reacted quickly and a section 7 review in terms of the Banks Act on corporate governance by Deloitte and Touche was commissioned. Various meetings were held as reporting progressed and a final report prepared by Mr Gerry Schipper was later tabled to which Holdings had to respond. The Registrar later stated that he would have removed Levenstein and reconstituted the board, if he had the power to do so. The eventual report highlighted more than 20 unsatisfactory matters as regards the inner workings of Regal Bank. The time for reaction by the BSD had arrived: Levenstein had to be removed, and at least four suitably qualified independent non-executive directors and a new chairman and CEO had to be appointed, but unfortunately the required action was neither swift nor decisive, leaving Levenstein as CEO until 18 June 2001.

- 24 A response by Holdings to the report could not have persuaded that the required steps were not warranted but, instead of acting, the BSD solicited certain legal advice, insisted on certain corrective steps and instructed Ernst & Young to verify that certain remedial steps had been taken.
- 25 During 2000 and early 2001 various improvements were effected, but on 25 June 2001 Ernst & Young notified the BSD that it intended withdrawing consent to preliminary results of Holdings for 2001. Reasons advanced included that certain information had been withheld and that certain untrue representations had been made. As became apparent later, the 2001 preliminary results were inaccurate because (a) Holdings did not make full and accurate disclosure of material information; (b) of Levenstein's non-disclosures, and (c) Ernst & Young did not request certain material information.
- 26 The share price plunged, confidence in the bank was lost and eventually on Wednesday 27 June 2001 the bank was put under curatorship. It was one of the smallest banks to have failed, with only 1 600 depositors and a balance sheet of R1,6 billion.

B. Failure of corporate governance

- 27 Levenstein was not a fit and proper person to be an executive director, CEO and chairman of Holdings and the bank in that:

- he did not exercise the utmost good faith and integrity in his dealings with and on behalf of the bank;
- he did not exercise reasonable skill and care;
- he did not always act in the best interests of the bank, depositors and shareholders;
- he permitted a conflict of interest to arise between his interests and those of the bank, its depositors and shareholders;
- his management of the bank was incompetent and amateurish;
- he acted dishonestly and fraudulently;
- he confused corporate governance with thuggery.

28 In summary he lacked three of the qualities of a director required of a bank in terms of s1A(a) of the Banks Act, namely, probity, competence and soundness of judgment. He ran the bank with little sophistication. He had no idea of the concept of corporate governance and, even if he did have, he was indifferent to it. Levenstein carried on the business of the bank and Regal Holdings in a reckless manner.

29 The directors, executive and non-executive of Regal Holdings and Regal Bank acted in breach of the Banks Act and the regulations relating to banks³ in that they failed:

³ Regulations published on 28 April 1996 in the Government Gazette 17115 (“the regulations”).

- to act exclusively in the best interests and for the benefit of Regal Holdings, Regal Bank and its depositors;
- to perform their functions with diligence and care and with such a degree of competence as could reasonably be expected from a person with their knowledge and experience;
- to ensure that the risks that were of necessity to be taken by the bank were managed in a prudent manner.

30 The directors acted in breach of the standards of corporate governance recommended by the King Report in that they failed:

- to exercise the utmost good faith, honesty and integrity in all their dealings with or on behalf of Regal Holdings and the bank;
- to exercise the care and skill which can reasonably be expected of persons of their expertise;
- to act in the best interests of Holdings and the bank;
- to ensure that the bank's strategies were collectively agreed by the board;
- to ensure that the boards of Holdings and the bank monitored the performance of management against budgets or business plans or industry norms.

- 31 The directors failed to ensure that the audit committee operated in accordance with the Banks Act and the King Report and were knowingly party to the carrying on of business in a reckless manner.
- 32 The respects in which the audit committee operated in breach of the Bank's Act and the King Report were the following:-
- While Levenstein was chairman of the bank of Holdings he was a member of the audit committee.
 - The auditors, Ernst and Young, were not invited to all audit committee meetings.
 - The audit committee did not consider, let alone approve, the interim financial results of 31 August 1999.
 - The audit committee did not consider, let alone approve the results of 16 May 2000.
 - The audit committee did not review the Mettle transactions.
 - The audit committee did not revise the Pekane transaction in terms of which Regal Bank paid Pekane R60m for its Regal shares.
 - The audit committee did not review the transactions in terms of which Regal Bank financed the acquisition of Regal Holdings shares by the trusts and related parties.
 - The CFO from August 2000, de Castro, was not invited to attend audit committee meetings.

- 33 In terms of the King Report, every director, whether an executive or a non-executive director has equal responsibility. Directors have an equal and heavy responsibility when it comes to the question of good faith. It cannot be said that because someone is a non-executive director the duties are less onerous than they would have been if the director had been an executive director. One of the priorities of a non-executive director is to monitor and review the performance of the executive management more objectively than the executive director.
- 34 The inherent problem lay with the composition of the non-executive directors. The non-executive directors were elderly retired men or friends or relatives of Levenstein with the exception of one non-executive director. After the bonus dispute he had with Levenstein in January 2000, he played no further part in the affairs of the bank until Worldwide sold its shares.
- 35 The non-executive directors were either not aware of their duties and responsibilities or were aware and acted in conflict with their duties and responsibilities. They were not prepared to do what Mark Springett described as “facing the bully in the schoolyard”. The non-executive directors might just as well have been playing bowls on a hot Sunday afternoon for all the energy they put into the discharge of their duties.
- 36 The non-executive directors of Holdings and the bank received no remuneration. The value of their contribution to Regal Bank was equal to their remuneration.

37 In addition, the external auditors, Ernst & Young, acted in breach of the Public Accountants and Auditors Act⁴ and the Banks Act during the 2000 audit and gave consent to the release of the 2001 preliminary financial results of Regal Holdings when they had not completed the 2001 audit properly.

38 The directors were elected by the shareholders of Regal Holdings. The shareholders who held Regal Holdings shares at the date of curatorship have lost their whole investment. They have no one else to blame but themselves. It was the directors that *they* elected whose actions were the main cause of the collapse of Regal Bank. In mitigation, the board of directors, its chairman, Lurie and Levenstein, its chief executive officer, kept the shareholders in the dark about the “dark side” of “Levenstein and company”. The shareholders were always given a (distorted) rosy picture containing vistas of riches.

Source: Report of the Commissioner, Adv JF Myburgh SC, in terms of s69A (11) of the Banks Act, 94 of 1990, 15 November 2001

⁴ Act 80 of 1991 (“PAAB Act”)