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Ponzi Schemes: Has the South African Government done enough to protect South African citizens?

by

Inben Naidoo

(18342826)

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Supervisor: Prof R Brits

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Inben Naidoo

October 2019

Summary

This dissertation seeks to analyse Ponzi schemes in South Africa while evaluating the legislative prescripts that govern how Ponzi schemes are criminalised and investigated in South Africa. The dissertation will analyse the investigation of Ponzi Schemes as well as repayment administration of a Ponzi scheme in South Africa. Lastly, the dissertation will cover the criminal prosecution of a Ponzi scheme in South Africa. A critical discussion will be provided on the possible failures of the regulators, law enforcement agencies as well as financial institutions in relation to Ponzi schemes and the harmful impact they have on the general public.

Acknowledgements

[to be added after the examination process is completed]

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Chapter 1:
Introduction

If you ever heard the saying “If it’s too good to be true, it probably is”, then you may have encountered what is known today as a Ponzi scheme. Like most criminal schemes, Ponzi schemes have spread throughout the world and appears, albeit in slightly different forms, in many different types of societies. The scheme fuels an individual’s need to make money quickly and is commonly called a “get rich quick scheme”. While not much is known about these types of schemes prior to 1994 and democracy in South Africa, it has become a common scheme operated, or attempted to be operated within South Africa today. In a country with extremely high unemployment, as well as a large income gap between the rich and the poor, these schemes provide individuals with the hope of living a better life with little to no effort. Unbeknownst to the victims of these schemes, by investing in such enterprises, you are almost guaranteed to lose your money if you continue investing in such schemes. The question we as South Africans need to ask ourselves is, has the South African Government done enough to protect the innocent and ordinary member of society who may not have been informed adequately of such schemes and thus, easily succumb to the allure of making money quickly with little to no effort. The Prudential Authority, previously called the Banking Supervision Department (“BSD”) a division of the South African Reserve Bank (“SARB”), in their annual report in 2016, disclosed that a total of 27 different possible Ponzi schemes were being investigated by the BSD at that time.[1] With potentially millions of rands involved in each scheme, this may ultimately lead to normal citizens losing vast amounts of money. Yet, as South African citizens, little is heard about the outcome of these investigations, prosecutions of individuals (if any) or return of funds to victims of the scheme.

Mr Charles Ponzi (“Mr Ponzi”) was born in Italy and subsequently immigrated to the United States of America. Mr Ponzi is the man who invented the idea of convincing investors to place their money with him in exchange for the promise of exorbitant returns. To the innocent investor, this would seem like an unmissable investment opportunity. Mr Ponzi allegedly promised investors returns of approximately 50

[1] Bank Supervision Department Annual Report (2016) 8.

percent in 45 days and 100 percent in 90 days. Unbeknown to these innocent investors, Mr Ponzi actually paid these high returns with money received from new investors who he recruited to invest with him. The scheme unravelled pursuant to an investigation conducted by local newspapers which further caused a "run" on the scheme whereby numerous, if not all, investors tried to withdraw their money from the scheme. While Mr Ponzi subsequently served prison sentences for the crimes he committed, the simple scheme he has created has come to be known as the "Ponzi Scheme".[2] While many have formed different names and formulated different variations of the method, the underlying premise of each scheme is very similar. It would comprise of a promise to provide an individual with high percentage returns on investment, whereby interest on the investment accrues either daily, weekly or on a monthly basis. These exorbitantly high returns are usually paid by way of utilising the funds of individuals who join the scheme later on and there is thus no legitimate underlying business or investment from which individuals can receive legitimate returns.

The main objective of this dissertation can be broken down into the following aspects, which will be considered the three following chapters respectively:

1. To explore the legislative prescripts which dictate how Ponzi schemes are investigated, and if possible repaid, within South Africa;
2. a look at an investigation and subsequent repayment of a Ponzi scheme; and
3. a review of criminal prosecutions of a Ponzi scheme and the perpetrators thereof.

With the above in mind, I will seek to conclude on the following:

- Whether or not the Government has done enough to protect ordinary South African citizens who are victims of these schemes;
- whether the government has done enough to prevent Ponzi schemes from occurring;
- whether the perpetrators of said schemes are brought before a court of law in respect of these schemes; and

[2] https://www.biography.com/people/charles-ponzi-20650909 (accessed 15-04-2019).

- through available information on known Ponzi schemes outline the amount of money possibly lost by innocent individuals when investing in these schemes.

Chapter 2:
The legislative prescripts which dictate how Ponzi schemes are investigated, and if possible repaid, within South Africa

This chapter will entail a review and analysis of the following legislation that are relevant for the investigation and repayment of Ponzi schemes:

- South African Reserve Bank Act 90 of 1989 ("SARB Act");
- Banks Act 94 of 1990 ("Banks Act");
- Inspection of Financial Institutions Act 80 of 1998 ("Inspections Act");
- Unfair Business Practice Act 71 of 1998 ("Unfair Business Practice Act");
- Financial Intelligence Centre Act 38 of 2001 ("FICA"); and
- Financial Sector Regulation Act 9 of 2017 ("FSRA").

In order to protect ordinary South Africans against the harmful impact of Ponzi schemes, the government inserted clauses into various legislation, which deal with the investigation, prevention as well as repayment of Ponzi Schemes. The SARB Act states that the primary objective of the South African Reserve Bank ("SARB") is "to protect the value of the currency of the Republic in the interest of balanced and sustainable growth in the Republic".[3] Of particular importance in respect of the investigation of Ponzi Schemes is section 11 of the SARB Act, which deals with the "Appointment of Inspectors" and states that the SARB may appoint "Inspectors" to look into any aspect of a bank or mutual bank.[4] Furthermore, the provisions of the Inspections Act would apply to any inspections conducted in terms of section 11(1) of the SARB Act.[5] Section 12 of the SARB Act deals with the "Inspection of affairs of person, partnership, close corporation, company or other juristic person not registered as bank or mutual bank" and states that the Governor or Deputy Governor has the power to appoint an inspector in terms of section 11 to investigate any individual or

[3] S 3 of South African Reserve Bank Act 90 of 1989.
[4] S 11(1) of South African Reserve Bank Act 90 of 1989.
[5] S 11(2) of South African Reserve Bank Act 90 of 1989.

entity, if they have reason to believe that an individual or entity is carrying on the "business of a bank or mutual bank".[6] Similarly, the provisions of the Inspections Act would apply to any inspections conducted in terms of section 12(1) of the SARB Act.[7] The definition of "the business of a bank" can be found in the Banks Act. The Banks Act *inter alia* defines "the business of a bank" as the acceptance of deposits from the general public as a regular feature of the business[8] coupled with a business actively advertising for deposits and seeking deposits from the public.[9] This definition is curtailed by the provision that "the business of a bank" does not include instances where a person does not purport to receive deposits from the general public on a regular basis and who does not advertise for such deposits.[10] This curtailment only applies to instances where a person does not hold deposits for more than 20 persons and the total sum of all deposits held does not exceed R500 000.[11] One can thus state that the appointment of an inspector in terms of the SARB Act is done with the sole purpose of determining whether an entity or individual's business activity falls within the ambit of the definition of "the business of bank" as mentioned above. Arguments have been put forward that in the ever-changing era of technology the definition of the "business of a bank" may be too narrow and not sustainable in the long run.[12] However, in the meantime, the definition relied upon is the one mentioned in the Banks Act.

One of the powers afforded to the Registrar of Banks in the Banks Act is to apply to the courts for orders prohibiting actual or potential contraventions of the Banks Act.[13] If the Registrar of Banks has reason to believe that an entity or individual is likely to contravene the relevant provisions of the Banks Act[14] or has contravened and/or will continue to contravene the provisions of the Banks Act,[15] the Registrar may do the following:

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[6] S 12(1) of South African Reserve Bank Act 90 of 1989.
[7] S 12(2) of South African Reserve Bank Act 90 of 1989.
[8] S 1 of the Banks Act 90 of 1994, para (a) of the definition of the "business of a bank".
[9] S 1 of the Banks Act 90 of 1994, para (b) of the definition of the "business of a bank".
[10] S 1 of the Banks Act 90 of 1994, para (aa) of the definition of the "business of a bank".
[11] S 1 of the Banks Act 90 of 1994, para (aa)(i) of the definition of the "business of a bank".
[12] H Kawadza "Rethinking the definition of the 'business of banking' in South Africa against the backdrop of *Registrar of Banks v Net Income Solutions*" (2015) 1 *JCCLP* 105-115 112.
[13] S 81 of the Banks Act 90 of 1994.
[14] S 81(1)(a) of the Banks Act 90 of 1994.
[15] S 81(1)(b) of the Banks Act 90 of 1994.

- the Registrar of Banks may apply to a court who has the relevant jurisdiction for an order prohibiting the potential contravention of the Banks Act;[16]
- prohibiting the contravention of the Banks Act from continuing;[17] and
- prohibiting the entity and/or individual concerned from disposing of their assets while the contravention is being investigated.[18]

The Banks Act further states that if the application made by the Registrar of Banks proves to the satisfaction of the courts[19] that a provision of the Banks Act will be contravened by an entity or individual,[20] that contravention will be continued or repeated,[21] or that the convention has already been committed,[22] the court may grant the relevant order applied for.[23] The Banks Act further provides for the repayment of money unlawfully obtained.[24] This happens subsequent to the inspection conducted in terms of section 12 of the SARB Act and where the Registrar of Banks is satisfied that a person has conducted "the business of a bank" without being registered as such.[25] The Registrar of Banks is further empowered to request the person who is unlawfully carrying on "the business of a bank" to repay all money obtained through the carrying on of its business, subject to the provisions of section 84 of the Banks Act.[26] Pursuant to the Registrar of Banks issuing a request as referred to in section 83(1) of the Banks Act, he will appoint an individual who will be tasked to manage and control the repayment of the money unlawfully obtained. This individual is referred to as the "manager".[27] Once the Manager is appointed, the individual who is unlawfully carrying on "the business of a bank" is prohibited from disposing of the assets, which were derived from the unlawful activity without the written consent of the Manager.[28] The duties of the Manager are vast and include the following responsibilities:

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[16] S 81(1)(i) of the Banks Act 90 of 1994.
[17] S 81(1)(ii) of the Banks Act 90 of 1994.
[18] S 81(1)(iii) of the Banks Act 90 of 1994.
[19] S 81(2) of the Banks Act 90 of 1994.
[20] S 81(2)(a) of the Banks Act 90 of 1994.
[21] S 81(2)(b) of the Banks Act 90 of 1994.
[22] S 81(2)(c) of the Banks Act 90 of 1994.
[23] S 81(2) of the Banks Act 90 of 1994.
[24] S 83 of the Banks Act 90 of 1994.
[25] S 83(1) of the Banks Act 90 of 1994.
[26] S 83(1) of the Banks Act 90 of 1994.
[27] S 84(1) of the Banks Act 90 of 1994.
[28] S 84(2) of the Banks Act 90 of 1994.

- Conduct additional investigations into the affairs of the entity and/or individual who was found to be unlawfully conducting the "business of a bank";[29]
- identify the actual amount unlawfully obtained,[30] the identities of the individuals who deposited into the scheme,[31] where any unlawfully obtained funds are located or kept,[32] and any other information which may assist in the repaying of monies unlawfully obtained;[33]
- if assets were purchased with the money which was unlawfully obtained, the manager has the authority to liquidate the assets in order to expedite the repayment of the funds;[34] and
- to report any suspected criminal offences to the respective prosecuting authorities.[35]

The purpose of the Inspections Act is to provide for the inspection of registered financial institutions as well as unregistered entities who are conducting the business of financial institutions.[36] The following powers are afforded to the Inspector in respect of institutions which are being inspected in terms of the Inspections Act:[37] The inspector may administer an oath or affirmation or interview any individual associated with the entity (which will include employees, directors, shareholders and partners);[38] conduct a search and seizure at any premises occupied by the entity as well as request any documents belonging to the entity;[39] open any safe or container in which the inspector suspects documents relating to the entity are kept;[40] examine any document and either make copies of any document relating to the entity or seize the documents and issue a receipt for the documents seized, but the documents can only be removed on a temporary basis;[41] seize any document and issue a receipt for the documents

[29] S 84(4)(a) of the Banks Act 90 of 1994.
[30] S 84(4)(a)(i) of the Banks Act 90 of 1994.
[31] S 84(4)(a)(ii) of the Banks Act 90 of 1994.
[32] S 84(4)(a)(iii) of the Banks Act 90 of 1994.
[33] S 84(4)(a)(iv) of the Banks Act 90 of 1994.
[34] S 84(4)(b) of the Banks Act 90 of 1994.
[35] S 84(4)(c) of the Banks Act 90 of 1994.
[36] Preamble to Inspection of Financial Institutions Act 80 of 1998.
[37] S 4(1) of the Inspection of Financial Institutions Act 80 of 1998.
[38] S 4(1)(a) of the Inspection of Financial Institutions Act 80 of 1998.
[39] S 4(1)(b) of the Inspection of Financial Institutions Act 80 of 1998.
[40] S 4(1)(c) of the Inspection of Financial Institutions Act 80 of 1998.
[41] S 4(1)(d) of the Inspection of Financial Institutions Act 80 of 1998.

seized if the Inspector believes that the document contains evidence of any offence or irregularity;[42] and the documents can be seized for the duration of the criminal and/or any other proceeding which may result from the inspection conducted.[43] The Inspector is further conferred with additional powers, which relate to persons associated and/or involved with the entity being inspected.[44] The powers of the Inspector relating to individuals are very similar to its powers with regard to entities, except that the Inspector should apply for a warrant when the powers relate to persons associated with the entity.[45] The provisions also allow for an inspector to proceed with an inspection without a warrant, provided that the individual in charge of any premises consents to the Inspector exercising his or her powers.[46] The Inspections Act further places an onus on the relevant Registrar to refer any offences or irregularities, identified during an inspection, to any relevant government department, organ of state or any other institution as envisaged in the Inspections Act.[47] The Inspection Act further makes it unlawful for individuals and/or entities to hamper the efforts of the Inspector in completing his or her inspection. An individual who contravenes the Inspections Act could be liable to a fine or imprisonment, not exceeding two years, or liable for both a fine and imprisonment.[48] This includes when the individual refuses to take an oath or affirmation;[49] refuses to answer a question posed by the inspector;[50] intentionally provides the inspector with false information;[51]; refuses to carry out lawful requests by the inspector during the course of him or her exercising his or her duties;[52] or knowingly hinders the inspector during the exercise of his or her duties.[53]

The Unfair Business Practice Act provides for the prevention or regulation of certain business practices.[54] The Unfair Business Practice Act provides for the establishment of a Consumer Affairs Committee[55] (“the Committee”). The Committee

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[42] S 4(1)(e) of the Inspection of Financial Institutions Act 80 of 1998.
[43] S 4(1)(f) of the Inspection of Financial Institutions Act 80 of 1998.
[44] S 5 of the Inspection of Financial Institutions Act 80 of 1998.
[45] S 5(1)(b) of the Inspection of Financial Institutions Act 80 of 1998.
[46] S 5(1)(b)(vi) of the Inspection of Financial Institutions Act 80 of 1998.
[47] S 9 of the Inspection of Financial Institutions Act 80 of 1998.
[48] S 12 of the Inspection of Financial Institutions Act 80 of 1998.
[49] S 12(a) of the Inspection of Financial Institutions Act 80 of 1998.
[50] S 12(b) of the Inspection of Financial Institutions Act 80 of 1998.
[51] S 12(c) of the Inspection of Financial Institutions Act 80 of 1998.
[52] S 12(d) of the Inspection of Financial Institutions Act 80 of 1998.
[53] S 12(e) of the Inspection of Financial Institutions Act 80 of 1998.
[54] Preamble, Unfair Business Practice Act 71 of 1998.
[55] S 2(1) of the Unfair Business Practice Act 71 of 1998.

is empowered to conduct a preliminary investigation, which will include engaging with any related entity and/or individual who is connected with an alleged unfair business practice.[56] Once a preliminary investigation is instituted, the Committee may summon any individual to appear before it or to produce any document that may be relevant for the purposes of the investigations[57] and the Committee may place any individual summoned under oath and may retain any relevant documentation produced by that person.[58] Individuals who are summoned to the committee and who fail to appear at the requested time or for the entire duration as stipulated by the Committee;[59] refuses to be sworn in or take an affirmation;[60] or pursuant to being sworn in, fails to answer any lawful question posed,[61] fails to produce the required documentation,[62] or gives false evidence while knowing that the evidence is false, will be guilty of an offence.[63] Investigators appointed by the Committee to investigate these alleged unfair business practices are provided with similar powers to that of inspectors in terms of the Inspections Act.[64] The Committee may further institute a full investigation using its own discretion.[65] Such an investigation may be conducted into any alleged unfair business practice[66] or into any business which deals with any commodity or investment which may create an unfair business practice.[67] Upon recommendation from the Committee, pursuant to the investigation conducted, the Minister of Trade and Industry may take the necessary action to prevent an identified unfair business practice from occurring,[68] attach any funds or property which has been subject to the investigation and which is held by any individual mentioned during the investigation, and then hold the funds until a curator is appointed in terms of section 12(2) of the Unfair Business Practice Act.[69] The Minister of Trade and Industry may further prohibit identified individuals from disposing of assets or funds in any way.[70]

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[56] S 4(1)(c) of the Unfair Business Practice Act 71 of 1998.
[57] S 5(1)(a) of the Unfair Business Practice Act 71 of 1998.
[58] S 5(1)(b) of the Unfair Business Practice Act 71 of 1998.
[59] S 5(4)(a) of the Unfair Business Practice Act 71 of 1998.
[60] S 5(4)(b) of the Unfair Business Practice Act 71 of 1998.
[61] S 5(4)(c)(i) of the Unfair Business Practice Act 71 of 1998.
[62] S 5(4)(c)(ii) of the Unfair Business Practice Act 71 of 1998.
[63] S 5(4)(c)(iii) of the Unfair Business Practice Act 71 of 1998.
[64] S 7 of the Unfair Business Practice Act 71 of 1998.
[65] S 8(1) of the Unfair Business Practice Act 71 of 1998.
[66] S 8(1)(a) of the Unfair Business Practice Act 71 of 1998.
[67] S 8(1)(b) of the Unfair Business Practice Act 71 of 1998.
[68] S 8(5)(a)(i) of the Unfair Business Practice Act 71 of 1998.
[69] S 8(5)(a)(ii)(aa) of the Unfair Business Practice Act 71 of 1998.
[70] S 8(5)(a)(ii)(bb) of the Unfair Business Practice Act 71 of 1998.

As seen in both the Unfair Business Practice Act as well as the Banks Act, the legislature has foreseen the harm which may be caused by potential Ponzi schemes and has sought to provide for adequate investigative measures to prevent such schemes from occurring as well as to provide for the repayment of individuals who have participated and who may have lost funds through investing in Ponzi schemes. However, the practicalities and the ease with which these investigations are conducted as well as the timeframes involved when conducting such investigations do not seem to have been considered by the legislature. Furthermore, the costs associated with conducting the investigations compared to the amount of funds in a particular scheme or business practice also does not seem to have been considered. The next piece of legislation that needs to the looked and which may assist with the investigation and identification of Ponzi schemes is FICA. FICA is primarily aimed at identifying the proceeds of unlawful activities and the combating of money laundering as well as the financing of terrorist related activities.[71] Entities who are required to comply with FICA are identified as "accountable institutions", a list of which can be found in schedule 1 of FICA. Entities who conduct the "business of a bank" in terms of the Banks Act are one of the entities identified as accountable institutions. The Financial Intelligence Centre ("FIC") was established in terms of FICA and is tasked with enforcing the requirements of FICA and to drive the fight against money laundering and the financing of terrorist related activities.[72] In order to combat money laundering and terrorist related activity, there are numerous obligations placed on accountable institutions in relation to the way they conduct business with their clients. Accountable institutions have an obligation to take certain prescribed steps prior to them establishing a business relationship with a client or even concluding a single transaction with a client.[73] The client's identity needs to be verified by the accountable institution.[74] If the client acts on behalf of someone else, the identity of the other individual needs to be known and the authority of the client to act on behalf of someone else needs to be established.[75] The accountable institution is also obliged to keep proper records when entering into a business relationship with a client.[76] The records to be kept include the

[71] S 3 of the Financial Intelligence Centre Act 38 of 2001.
[72] Preamble of the Financial Intelligence Centre Act 38 of 2001.
[73] S 21(1) of the Financial Intelligence Centre Act 38 of 2001.
[74] S 21(1)(a) of the Financial Intelligence Centre Act 38 of 2001.
[75] S 21(1)(b) of the Financial Intelligence Centre Act 38 of 2001.
[76] S 22(1) of the Financial Intelligence Centre Act 38 of 2001.

identity of the client,[77] the nature of the transaction,[78] the amount involved,[79] the parties to the transaction[80] and all accounts involved in relation to all transactions concluded by the accountable institution on behalf of the client.[81]

In addition to keeping proper records and identifying clients adequately, an accountable institution is obliged to notify the FIC in respect of certain transactions regarding their clients. One of the reporting obligations deals with cash transactions above the prescribed limit and dictates that an accountable institution should report all cash transactions initiated by the client which is above the amount of R25 000.00.[82] One of the more important obligations of accountable institutions is the duty to report suspicious and unusual transactions.[83] FICA gives guidance on potential red flags for accountable institutions when identifying potentially suspicious or unusual transactions. These red flags are *inter alia* the following:

- If an individual employed by an accountable institution suspects that they are about to receive the proceeds of illicit activities or property associated with terrorist activities;[84]
- Suspects that it is involved or likely to be involved in the transfer of funds which relate to unlawful activity or property which is linked to an offence relating to terrorist financing or similar activities;[85]
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- the transaction has no lawful business purpose;[86]
- the transaction is conducted for the purposes of avoiding reporting obligations under FICA;[87]
- the transaction is relevant to a tax evasion investigation conducted by the South African Revenue Service;[88] and

[77] S 22(1)(a) of the Financial Intelligence Centre Act 38 of 2001.
[78] S 22(1)(e) of the Financial Intelligence Centre Act 38 of 2001.
[79] S 22(1)(f)(i) of the Financial Intelligence Centre Act 38 of 2001.
[80] S 22(1)(f)(ii) of the Financial Intelligence Centre Act 38 of 2001.
[81] S 22(1)(g) of the Financial Intelligence Centre Act 38 of 2001.
[82] S 28 read with Regulation 13 of the Financial Intelligence Centre Act 38 of 2001.
[83] S 29 of the Financial Intelligence Centre Act 38 of 2001.
[84] S 29(1)(a) of the Financial Intelligence Centre Act 38 of 2001.
[85] S 29(1)(b)(i) of the Financial Intelligence Centre Act 38 of 2001.
[86] S 29(1)(b)(ii) of the Financial Intelligence Centre Act 38 of 2001.
[87] S 29(1)(b)(iii) of the Financial Intelligence Centre Act 38 of 2001.
[88] S 29(1)(b)(iv) of the Financial Intelligence Centre Act 38 of 2001.

- the accountable institution is about to be utilised for the purposes of money laundering.[89]

If the accountable institution suspects that any of the above instances have been committed, the accountable institution should report all available information around the suspicion to the FIC within 15 days, excluding weekends and public holidays.[90] An accountable institution further has a duty of confidentiality towards the FIC when making these suspicious or unusual transaction reports. Thus, they cannot disclose to their client or any other person that they have raised a suspicious or unusual transaction report in terms of FICA.[91] If the FIC, pursuant to a suspicious or unusual transaction report being lodged by an accountable institution, has reasonable grounds to suspect that certain transactions may involve the proceeds of illicit activity, the FIC may direct the accountable institution not to proceed with the transaction for 5 days pending further investigation by the FIC as well as possible referral of the matter to the National Director of Public Prosecutions ("NDPP").[92] It should be noted that this dissertation focusses on legislation enacted prior to the implementation of the FSRA, as the majority of the schemes dealt with in the dissertation deal with schemes which were operated during the time of the aforementioned legislation.

The last legal prescript, while not legislative, that needs mentioning is the common law principle of fraud. According to Snyman[93] fraud is the unlawful and intentional making of a misrepresentation which causes actual prejudice or which is potentially prejudicial to another. The mention of fraud is necessary in that while individuals who conduct Ponzi schemes can be charged with the criminal offence of conducting the unauthorised business of the bank as listed under the Banks Act, the perpetrators of the scheme can also be charged with fraud. In most instances, innocent investors are lured into the scheme on the pretence that they are investing in a lawful scheme when in fact they are being misrepresented by the perpetrators of the scheme, with the resulting effect of the innocent investors being prejudiced by losing the money that they invested in the scheme. While the South African government has

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[89] S 29(1)(c) of the Financial Intelligence Centre Act 38 of 2001.
[90] S 29(1)(c) read with Regulation 24 of the Financial Intelligence Centre Act 38 of 2001.
[91] S 29(3) & (4) of the Financial Intelligence Centre Act 38 of 2001.
[92] S 35 of the Financial Intelligence Centre Act 38 of 2001.
[93] CR Snyman *Criminal Law* 3rd ed (1995) 487.

enacted legislation which criminalises as well as facilitates investigations into Ponzi schemes, the perpetrators of the scheme could just be charged with fraud and be prosecuted as such. The very crux of a Ponzi scheme is the misrepresentation which entices an innocent investor to invest money in the scheme. The Ponzi scheme thus falls directly within the definition of fraud. It further means that the investigation of Ponzi schemes should also be conducted by the South African Police Service and not just by the inspectors appointed in terms of the above-mentioned legislation.

Chapter 3:
Investigation and subsequent repayment of a Ponzi scheme

Net Income Solutions, which was commonly known as Defencex, was one of the largest Ponzi schemes in South African history.[94] The ensuing paragraphs will deal with the judgment handed down in the Western Cape High Court in the case of *Registrar of Banks v Net Income Solutions and Others*[95] ("the *Defencex* case"). As per the judgement handed down in the *Defencex* case, the accounts of Defencex reflected an amount of approximately R324 million before they were frozen.[96] The inspectors discovered that the basic premise of the Defencex scheme was that depositors would purchase points at a cost of R100.00 per point. In return, these depositors would earn R2.00 per day for a period of 75 days. This brings the total amount earned per point to R150.00[97] (made up of the initial R100.00 deposited and R50.00 earned over the 75 day period). In addition to the above, there was a multi-level marketing element to the scheme in that an individual (called a team leader) could earn a 10% commission on all points purchased by individuals (direct referrals) who were referred by him or her to the scheme.[98] The team leader could earn a further 5% commission from depositors recruited by his direct referrals.[99]

The court made reference to Government Notice 498 of 27 March 1997 ("Government Notice"), which was made by the Registrar of Banks and contained activities which would constitute the "business of a bank".[100] They are *inter alia* as follows:

> "the acceptance or obtaining of money, directly or indirectly, from members of the public, as a regular feature of a business practice, with prospect of such members (referred to as "participating members") receiving payments or other money related benefits directly or indirectly;

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94 https://www.biznews.com/wealth-building/2014/04/17/defencex-winners-must-pay-losers-hard-lessons-pyramid-scheme-fiasco (accessed 28-09-2019).
95 (3056/13) [2013] ZAWCHC 92.
96 *Registrar of Banks v Net Income Solutions and Others* (3056/13) [2013] ZAWCHC 92 para 14.2.
97 Ibid para 15.2.
98 Ibid at n 96 para 15.3.
99 Ibid at n 96 para 15.4.
100 Ibid at n 96 para 25.1.

> on or after the introduction of other members of the public (referred to as "the new participating members") to the business practice from which new participating members, in their turn, money is accepted or obtained, directly or indirectly, as a regular feature of the business practice;
> the soliciting of, or advertising for, directly or indirectly, money and/or persons for introduction into or participation in a business practice as defined in the preceding two sub-paragraphs".[101]

"Business practice" is further defined in the judgment to mean the following:

> "Any agreement, arrangement or understanding whether legally enforceable or not, between two or more persons; or any scheme, practice or method of trading, including any method of marketing or distribution".[102]

The court accordingly held that in order to prove that an entity is conducting the "business of a bank", one would need to prove either the definition of the "business of a bank" as defined in the Banks Act or the definition of "business practice" as defined in the Government Notice.[103] Furthermore, the court reiterated that the main purpose of the *rule nisi*, which was being sought by the SARB was for Defencex to be prohibited from conducting the "business of a bank" as well as to be prohibited from disposing of the assets of the entity while the contravention of the Banks Act is further investigated.[104] The court further made mention of the requirements under which a court may grant an order prohibiting an entity from conducting the business of bank as set out in section 81 of the Banks Act.[105] The court's interpretation of section 81 is that it should be proved that there is a reasonable likelihood that the entity will continue to contravene section 11(1) of the Banks Act. In addition, in order to grant the order prohibiting the individuals from disposing of the assets of the entity in any way, one would need to prove that there is a reasonable likelihood that section 11(1) has been contravened.[106] In order to prove the requirements of section 81(1), you will be required to prove that there is a reasonable prospect that the contraventions by the entity concerned will occur again.[107] In dealing with the definition of the "business of a

[101] Ibid at n 96 paras 25.1 to 25.3.
[102] Ibid at n 96 para 26.
[103] Ibid at n 96 para 27.
[104] Ibid at n 96 para 30.
[105] Ibid at n 96 para 31.
[106] Ibid at n 96 para 31.
[107] Ibid at n 96 para 32.

bank", the court looked at the definition of the "business of a bank" as defined in the Banks Act, coupled with Government Notice 1134 of 1999 and developed the elements of a business of a bank, namely[108] the acceptance of deposits from members of the general public;[109] as a regular feature of the business;[110] where the members should receive a direct or indirect monetary benefit;[111] the monetary benefits could also be received after the introduction of members of the public to the business;[112] and these funds would be paid from existing or new participating members of the business.[113]

When dealing with the merits of the case, as stated in court documents, there were a total number of 195233 usernames who had registered with Defencex. According to the appointed inspectors, a total number of 218391 individual deposits were paid into the scheme which totalled approximately R800 million. In the court's view, this satisfied the first part of the definition of the "business of a bank" in that it appears that deposits were accepted from the general public.[114] In order to satisfy itself that this was the main feature of the business, the court looked at information provided by the inspectors, which showed that 92.2% of the funds deposited into the business account of the entity were from individuals who participated in the scheme. The court concluded that accepting deposits from the general public was indeed a regular feature of the business.[115] The court looked further at the information provided by the inspectors, which concluded that between April 2012 and February 2013, utilising different payment methods, a total of 199 379 payments totalling R300 million were made to members of the public participating in the scheme. This satisfied the third element of the "business of a bank" as articulated above.[116] By the admission of Mr Chris Walker ("Mr Walker"), the individual who operated Defencex, if an individual invited other members of the public to join the scheme, the individual would be rewarded with commission. The conclusion is thus made that money was accepted either directly or indirectly as a regular feature of the business. This satisfied the next

[108] Ibid at n 96 para 39.
[109] Ibid at n 96 para 39.1.
[110] Ibid at n 96 para 39.2.
[111] Ibid at n 96 para 39.3.
[112] Ibid at n 96 para 39.4.
[113] Ibid at n 96 para 39.5.
[114] Ibid at n 96 para 40.
[115] Ibid at n 96 para 41.
[116] Ibid at n 96 para 42.

two elements of the “business of a bank”.[117] The inspectors further determined that Mr Walker and/or Defencex did not attempt to reinvest the funds deposited by members of the public. The funds merely remained in the business account of Defencex and no revenue was generated by way of investing the funds to obtain higher yields for investors. Thus, the only way in which funds could be repaid to members by virtue of the rules of the scheme, as mentioned above, was to utilise the funds of new and/or existing members of the scheme.[118]

Defencex and/or Mr Walker, in defending the court case, put forth a number of defences in order to refute that they conducted the “business of a bank” as defined in the Banks Act. They put forth two primary defences, the first being that individuals were purchasing points in Defencex for the primary reason of attending workshops relating to emotional freedom techniques. They further relied on a disclaimer contained on the Defencex website which stated that participants in Defencex were purchasing products and/or services and were not making any investment in Defencex.[119] However, the court emphatically rejected these defences as attempts to convert an illegal operation into a legal one. The court agreed with the analysis of the inspectors, namely that what they put forth was the true nature of the scheme.[120] The defence was also rejected with evidence that only three workshops were attended by a total of 150 people between September and November 2012. No workshops were conducted thereafter, during which time (November 2012 to February 2013) the scheme grew exponentially from approximately 31000 members to approximately 195000 members. Thus, the members who actually attended the workshops make up less than one per cent of all the members of the scheme.[121] In the opinion of the court, there was substantial evidence confirming that Defencex was conducting the business of a bank. Furthermore, based on their opposition to the application as well as their numerous defences, it does not appear that they would stop conducting their activities should the appropriate order not be granted.[122]

In addition to the defences raised above, Mr Walker took issue with the Registrar requesting an order freezing his personal bank account. According to Mr Walker, there

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[117] Ibid at n 96 para 43.
[118] Ibid at n 96 para 44.
[119] Ibid at n 96 para 50.
[120] Ibid at n 96 para 51.
[121] Ibid at n 96 para 52.
[122] Ibid at n 96 para 56-57.

was no mention made of him personally being suspected of conducting the "business of a bank". He further stated that he never personally deposited any funds into the scheme. He further stated that at all times he acted as a representative of Defencex and that he never took any decisions with regard to how investor funds would be re-invested. Lastly, Mr Walker stated that he never personally received any deposits into this own personal account.[123] However, evidence presented by the inspectors contradicted Mr Walker's version of events. He acted as the sole member of the close corporation, operated the bank accounts associated with Defencex and diverted funds from the Defencex bank account to his own personal bank account. The inspectors further discovered that the bank accounts in the name of Defencex belonged to Mr Walker in his personal capacity, which allowed the court to make the conclusion that Defencex was merely Mr Walker operating under the veil and disguise of a legal entity.[124]

In their last attempt to put up a defence, the respondents argued that the operations and idea of Defencex may have been to operate a stokvel, which is excluded from the definition of the "business of a bank". The respondents further relied on a Government Notice issued in 2006, which provided for the definition of a stokvel and the circumstances under which an entity could be considered one.[125] However, the court concluded that the scheme operated by Defencex fell outside of the scope of the definition of a stokvel as envisioned in the Government Notice.[126] The court accordingly held that Defencex accepted deposits from the general public as a regular feature of its business.[127] The court made the final order whereby Defencex and Mr Walker were prohibited from conducting the "business of a bank", which included accepting deposits from the general public or attempting to advertise to solicit deposits from the general public. They were further prohibited from disposing of the assets of the entity in any way until the investigation by the inspector had been finalised. The bank holding the bank accounts of Defencex and Mr Walker was ordered to freeze these accounts pending the finalisation of the investigation by the inspectors.[128]

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[123] Ibid at n 96 para 58-59.
[124] Ibid at n 96 para 60-61.
[125] Ibid at n 96 para 63.
[126] Ibid at n 96 para 65.
[127] Ibid at n 96 para 66.
[128] Ibid at n 96 para 69.

The court order thus allowed the inspectors to continue finalising the investigation into Defencex without any hindrances or obstacles from Mr Walker. As mentioned above, the amount of funds remaining in the bank accounts of Defencex totalled approximately R324 million. The amount of funds held by Defencex was by no means a small sum of money. In addition to the approximate amount of R324 million that was held in the bank accounts of the scheme at the time of the court proceedings, the inspectors found that a total of approximately R800 million flowed through the bank accounts of Defencex. In this respect, the conduct of the financial institution that held the bank accounts of Defencex needs to be called into question. In terms of section 29 of FICA, there is an obligation placed on all financial institutions to report suspicious transactions to the FIC. This is a mandatory statutory obligation placed on all financial institutions and this supersedes any confidentiality arrangements that a financial institution may have with their clients. As per the Money Laundering and Terrorist Financing Regulations (GN R1595 in GG 24176 of 20 December 2002) ("the regulations"), regulation 24 states that a financial institution has 15 working days to report any suspicious transactions to the FIC. As mentioned above, the scheme grew from a total of 31000 members to approximately 195000 members between November 2012 and February 2013, with a total number of approximately 218391 deposits being made by the public during the lifespan of the Defencex bank accounts. Furthermore, 199379 payments were made to the pubic totalling approximately R300 million during the period of April 2012 to February 2013. This activity should have warranted additional scrutiny on the part of the financial institution that held the account for Defencex. If the financial institution picked up the suspicious nature of the accounts sooner, this may have potentially saved members of the public millions of rand. Furthermore, if these transactions were reported timeously to the FIC, then swift action should have been taken by the FIC as well as the SARB to identify this potential scheme more efficiently and to the benefit of the general public. The early detection of these schemes by financial institutions, the FIC and the SARB, are of great importance to the general public. The failure to act on actionable information can be considered a failure to the investors who participated in the scheme and which may have lost large sums of money.

The next aspect of the chapter deals with the subsequent repayment administration that was conducted in respect of Defencex. Based on the information supplied in the court proceedings, as mentioned above, there was a need to appoint

individuals to facilitate the repayment of the funds to investors in the scheme as envisioned by section 84 of the Banks Act. The same inspectors who were appointed to perform the initial investigation into Defencex were subsequently appointed as the repayment administrators of the scheme in February 2014.[129] In order to assist with the repayment of investors, the repayment administrators created a web based application which utilised the underlying core investor information obtained from Defencex as well as deposit and repayment information obtained from bank statements.[130] Depositors who participated in Defencex were required to create a new user profile on the web application in order to facilitate the lodging of a claim with the repayment administrators.[131] Depositors were required to provide the usernames utilised during the Defencex scheme, and the repayment administrators web application would then verify the Defencex usernames supplied by the depositor. No user profile would be registered without a depositor submitting a valid Defencex username.[132] Once depositor information is verified by the repayment administrators, the depositor would be able to log on to his profile and start the process of lodging a claim with the repayment administrators.[133] The depositor would then be required to submit details (such as the date of deposit, amount, type of deposit) and an option to upload proof of the deposit with reference to each deposit made with Defencex.[134] This deposit information would then be verified by the repayment administrators, which would culminate, if all information is correct, in the depositor lodging a successful claim with the repayment administrators.[135] The repayment administrators were also aware that a depositor with Defencex may not have lost any money with the scheme due to them receiving higher returns compared to what the depositor initially put in. For instance, an individual might have deposited R100, but after inviting individuals, earning commission, as well as supposed dividends, the individual might have withdrawn an amount of R500. This situation resulted in the repayment administrators classifying depositors into two categories, namely “winners” and “losers”.[136] The

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[129] *Ex parte application: In Re: Net Income Solutions CC (NIS) Repayment Plan* (22499/14) (2016) ZAWCHC page 32.
[130] Ibid page 32.
[131] Ibid at n 129 page 34.
[132] Ibid at n 129 page 35.
[133] Ibid at n 129 page 36-37.
[134] Ibid at n 129 page 37.
[135] Ibid at n 129 page 38.
[136] Ibid at n 129 page 40.

repayment administrators envisioned an initial dividend to be made out to depositors of 65% of the total amount of funds owed to investors. Depositors who qualified for the dividends were either individuals who deposited with Defencex and received no funds in return or individuals who deposited in Defencex and received returns but the returns were below the proposed 65% dividend. If a depositor received more than the proposed initial 65% dividend, the depositor would not be entitled to any repayment.[137] A number of different scenarios can be extracted from this proposed repayment plan by the repayment administrators. The first scenario is probably the easiest and is when a depositor deposited R100 in Defencex and received no returns from Defencex. The depositor would then be entitled to R65 if a successful claim had been registered with the repayment administrators. The second scenario is where a depositor deposited R100 with Defencex and was repaid R50. The depositor would then be entitled to R15. The third scenario is where a depositor deposited R100 with Defencex and was repaid R70. Such a depositor, even if he or she successfully registered a claim with the repayment administrators, would not be entitled to any dividend. From the information provided by the repayment administrators in their court documents, it can be concluded that innocent depositors into Defencex lost approximately 35% of their money. Similarly, there must have been individuals who substantially benefited from the scheme and received much more than what they put in. This reality represents the essence of how a Ponzi scheme works and is operated.

The registration of Defencex depositors by the repayment administrators as well as the processing of claims began on 12 March 2015 and closed on 31 August 2015. It was initially proposed to end on 31 July 2015 but an extra month was allowed for late registrations.[138] At the end of this process, the repayment administrators were able to pay a 65% initial dividend, which amounted to approximately R131 million, to depositors who invested in Defencex.[139] Inexplicably, investors were paid a final dividend of 35%, which amounted to approximately R97 million.[140] This essentially means that investors who registered their claims in this first round of registration received all their money back. By doing so, the repayment administrators essentially paid individuals with funds that were not owed to them. As mentioned above, it was

[137] Ibid at n 129 page 42.
[138] Ibid at n 129 page 12 para 16-18.
[139] Ibid at n 129 page 13 para 23.
[140] Ibid at n 129 page 14 para 25.

initially envisaged that investors would only be able to obtain 65% of their deposits, as there were insufficient funds to refund each individual in full. The repayment administrators thus potentially prejudiced investors merely because they failed to register with them during the period when the repayment administration was conducted. An interesting consideration is if an investor is deceased and the estate was not aware of the deceased's investment with the scheme and therefore missed the chance to register with the repayment administrators. If the estate subsequently became aware of the investment in the scheme, the deceased estate would be prejudiced in that they would no longer be able to claim from the repayment administrators.

In addition to the dividends paid out under the first phase of the repayment administration, the repayment administrators requested permission from the court, which was subsequently granted, for them to relax the initial requirements in order to prove a claim with the scheme and merely pay out claims to individuals who registered correct Defencex usernames with the repayment administrators during the repayment administration registration phase. A further R70 million was paid out to investors who met this criterion.[141] The total remaining funds left with the repayment administrators amounted to R80 million of a total of R233 million potential claims remaining. This means that the remaining investors would get 34% of what the initially put into Defencex. According to the court papers submitted for the second phase of the repayment, the new claims registered with the repayment administrators amounted to R78 million.[142] Based on the calculations made by the repayment administrators, a 93.85% dividend would be paid to investors who registered during the second phase of the repayment administration.[143] As with the first phase of the repayment administration, investors who failed to register with the repayment administrators were prejudiced. However, it is arguable the investors who did not register with the repayment administrators should still be entitled to their claim against the scheme. The Reserve Bank as well as the courts were most likely consulted on this course of action and accordingly approved such repayment terms. While the repayment administration performed a good function in that innocent investors were returned their deposited

[141] Ibid at n 129 page 14-15 para 27-28.
[142] *Ex parte application: In Re: Net Income Solutions CC (NIS) Repayment Plan* (22499/14) (2016) ZAWCHC, stamped 12 December 2016 page 13 para 34.
[143] Ibid page 13 para 35.

funds, investors receiving 100% of their deposits back does not seem like a prudent course of action in this circumstance. Furthermore, there is a significant time lapse between when the scheme ended (February 2013) and when the second phase of the repayment administration was completed (December 2016). Taking into account inflation, investors who deposited funds into Defencex essentially received funds that are worth less than what it was when they initially invested in Defencex. This further demonstrates the harmful effects of Ponzi schemes and how they impact the lives of individuals. Investors in Defencex arguably would have been better off had they kept their funds in an interest bearing or fixed deposit account at a reputable financial institution. As mentioned in chapter 1, accountable institutions such as banks have a duty to report suspicious transactions. During the period April 2012 to February 2013, a total of 199,379 payments totalling R300 million were made into the bank accounts of Defencex utilising different payment methods. This should have raised suspicion with the accountable institution, which in turn should have resulted in suspicious or unusual transaction reports being submitted to the FIC. The FIC in turn has the powers to place a hold on transactions as well as notify the NDPP. This could have resulted in a different approach being taken to quickly shut down the scheme and prevent investors from losing their funds in the scheme. However, in the case of Defencex, the authorities were relatively slow in detecting the scheme and thus numerous investors lost funds in the scheme. There does appear a need for accountable institutions to strengthen their mechanisms to detect and eradicate Ponzi schemes. One also wonders why the SARB resorts to appointing external service providers to conduct inspections as well as repayment administrations, because the costs of appointing such service providers are considerably higher compared to having dedicated employees in the SARB to deal with such matters. This may also allow the SARB to act quicker in investigating schemes instead of having to wait to appoint an external service provider. An illustration of costs associated with the investigation of Ponzi schemes on behalf of the SARB can be found in the South African Reserve Bank Annual Report for 2015/2016 where when a question was posed by a shareholder as to why fees for audit services increased from R29 million in 2015 to R39 million in 2016. The reply was that the escalated costs were associated with investigations into Ponzi schemes.[144]

[144] South African Reserve Bank Annual Report 2015/2016 114

There have been instances where Parliament has also discussed the effects and impact which Ponzi schemes have on the country. During a parliamentary meeting where Ponzi schemes were discussed, the Financial Services Board (as it was known then) stated that a move to a twin peaks model of financial regulation would assist as one of the ways in which Ponzi schemes can be eradicated. The twin peaks model of financial regulation would ensure that financial service providers were required to go through the Financial Services Board (now known as the Financial Sector Conduct Authority). The Financial Services Board would also be empowered to publish reports of its investigations as well as imposing more stringent penalties.[145] With the Financial Sector Regulation Act 9 of 2017 only coming into effect as of 1 April 2018, it remains to be seen whether this new legislation would have a positive impact on the eradication of Ponzi schemes.

[145] https://pmg.org.za/committee-meeting/15263/ (accessed 28-09-2019).

Chapter 4:
Criminal prosecutions of Ponzi schemes and the perpetrators thereof

When researching prosecutions of Ponzi schemes, there appears to be very little available information on successful prosecutions or even cases which resulted in arrests being made of perpetrators of the scheme. However, one of the most publicised cases relates to that of Krion Financial Services ("Krion"). This chapter will focus on the Krion case that ended up being heard by the Supreme Court of Appeal ("SCA") and was reported as *Prinsloo v S*.[146]The scheme operated between March 2002 and May 2002 and was focused primarily in the Vaal Triangle but thereafter spread throughout the country. During the four years in which the scheme operated, approximately R1.5 billion was invested into the scheme.[147] Investors in the scheme were left destitute as there was very little money left in the scheme upon its collapse. The prosecutors levelled numerous charges against the accused that resulted in the final charge sheet having approximately 218683 charges.[148] The accused initially appeared in the High Court in July 2009 and were found guilty in June 2010. The accused were acquitted on 1000 charges, but given the number of charges levelled against them, they were given sentences of between 5 and 25 years.[149] According to the court, the evidence showed overwhelmingly that the scheme was a Ponzi scheme. The initial business created by the accused was a cash loan business, but this business never generated sufficient returns in order to justify the interest payments made to investors in the scheme.[150]

The scheme operated as follows: Krion would take deposits with the promise of 20% returns per month that later changed to 10% returns per month. The court did not provide a reason for the change from 20% returns to 10% returns. However, due to its business being that of a Ponzi scheme, it was insolvent.[151] An interesting point to note regarding the operation of the scheme is that both the Department of Trade and

[146] [2016] 1 All SA 390 (SCA).
[147] *Prinsloo v S* [2016] 1 All SA 390 (SCA) para 2.
[148] Ibid para 2.
[149] Ibid at n 146 para 3.
[150] Ibid at n 146 para 11.
[151] Ibid at n 146 para 11.

Industry ("DTI") and the SARB conducted inspections as well as made inquiries concerning the operations of the companies associated with the accused. However, the accused had provided the DTI and the SARB with incorrect information.[152] It is unclear why the information provided by the scheme was not tested further by either the DTI or the SARB to establish its veracity. Furthermore, inspectors were appointed on 6 June 2001 by the SARB to investigate the scheme. The scheme misrepresented to the inspectors the true nature of the amount of funds owed to investors. The scheme initially stated to the inspectors that between R10 million and R12 million was owed to investors, when in fact R320 million was owed to investors at the time of their misrepresentation to inspectors.[153] Pursuant to being approached and warned by the inspectors, investor files were moved to new premises. In addition, new entities were established in an attempt to disguise the true nature of the business.[154] The total value of investments made in Krion, which was separate from some of the initial entities, amounted to R956 million. However, on 4 June 2002, there was only an amount of R3,7 million left in the bank account of Krion. Due to the insufficient funds available, the entities that formed part of the scheme were liquidated in June 2002.[155]

In order to facilitate their scheme as well as to benefit from the deposits in the scheme, four trusts were set up by the accused to purchase various assets on behalf of the accused. The first trust purchased eleven properties totalling approximately R7,7 million,[156] the second trust purchased five properties totalling approximately R3,4 million,[157] the third trust purchased two properties totalling approximately R1,3 million[158] and the fourth trust purchased seven properties totalling R6 million.[159] Cumulatively 25 properties were purchased during the period that the scheme operated. These properties totalled approximately R18 million and the purchase prices were paid directly from the funds deposited by investors. There were no underlying loan agreements between the entities of the scheme which paid for the purchases of the assets and the trusts in whose name the assets were registered.[160] It should be

[152] Ibid at n 146 para 16-20.
[153] Ibid at n 146 para 25.
[154] Ibid at n 146 para 27-29.
[155] Ibid at n 146 para 30-31.
[156] Ibid at n 146 para 34.
[157] Ibid at n 146 para 35.
[158] Ibid at n 146 para 37.
[159] Ibid at n 146 para 38.
[160] Ibid at n 146 para 39.

noted that this sum of R18 million was a significant amount of money at the time. Considering inflation, it would be approximately R42 million in today's rand value.[161] This further illustrates how brazen the perpetrators of the Krion scheme were in the manner in which they utilised investor's funds, with a complete disregard for the innocent investors who were participating in their scheme. This illustrates the need for controls to be tightened in respect of identifying the source of funds when individuals purchase properties. Furthermore, there is a definitive need to scrutinise the manner in which trusts are used as individuals seek to hide behind the legal identity of a trust to hide the true beneficiary of illicit funds. Trusts are currently governed by the Trust Property Control Act 57 of 1988. While FICA has come into place since Krion and one would assume that the controls around identifying Ponzi schemes are significantly enhanced, there is hardly any new legislation that deals with trusts, the identity of the beneficiaries as well as the source of funds when trusts purchase assets. Furthermore, we still possess archaic mechanisms in obtaining trust documents and this is not readily available information, as is the case with registered companies or close corporations. In order to access information on a trust, you are required to write to the master of the high court in the jurisdiction where the trust is registered. The master will then consult with the trustees of the trust and thereafter make a determination to release the details of the trust to the person requesting the information. If the master of the high court refuses the request for information, a new application needs to be made to the information office in the Department of Justice.[162] Thus, trust information is difficult to obtain unlike that of a registered company.

The debilitating effect of Krion cannot be overstated. According to some of the statistics available, 75% of the investors in the scheme were older than the age of 40. From this 75%, a further 28%was between the ages of 50 to 97. Many of these investors were pensioners who invested their retirement packages into the scheme.[163] According to the court, the effects of such a scheme had an overwhelming financial and emotional impact on investors.[164] The evidence provided by some of the innocent investors demonstrated the severe impact the scheme had on the investors in that

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[161] https://inflationcalc.co.za/?date1=2002-06-30&date2=2019-09-29&amount=18000000 (accessed 29-09-2019).
[162] http://www.justice.gov.za/master/trust.html (accessed 18-10-2019)
[163] https://www.pressreader.com/south-africa/the-witness/20101015/281655366432965 (accessed 29-09-2019).
[164] Ibid at n 146 para 145.

investors had resorted to relying on other family members for financial support after the scheme had collapsed.[165] In the case of Krion, the DTI, the SARB as well as the inspectors should share a portion of the blame in relation to the scheme continuing for such a significant period of time. Inspectors were appointed in June 2001, but the scheme was only fully closed in June 2002. Krion should have been interdicted from conducting all business, with their bank accounts being frozen, pending the final outcome of the inspection. While the money of investors were lost, one would expect that a scheme of this magnitude would warrant swift prosecution. However, judgment and conviction in the High Court case of Krion was only handed down in 2009. This was almost eight years after the accused were initially arrested. The judge further stated that some of the mitigating circumstances in this case were that the accused had lost everything and that they were first time offenders. The judge further granted leave for the accused to appeal their sentences as well as an extension of bail.[166] It is difficult to ascertain how these circumstances should be considered as mitigating. One would not expect the accused to have significant funds available after the operation of the scheme or after the criminal cases against them. For the accused to be left with any funds, would most likely have been at the expense of innocent investors. Secondly, the fact that they were first time offenders should not have been considered mitigating. They were indicted on 281683 charges and the accused misled the DTI, the SARB as well as the inspectors, while their deliberate continuation of the scheme resulted in numerous individuals losing their livelihoods. While they were first time offenders, the crimes they committed would probably have an impact for years to come. The attitude of the lower court depicts the relatively soft stance taken towards white-collar criminals within the criminal justice system.[167] While the first accused was sentenced to 25 years imprisonment,[168] which was upheld on appeal, the remaining accused were not sentenced to similar jail terms while they were all severely complicit in the operation of the Ponzi scheme. A harsher sentence against all accused may act as a future deterrent for individuals who consider being part of the operations of a Ponzi scheme. As mentioned above, Ponzi schemes may have a devastating impact

[165] Ibid at n 146 para 146.
[166] Ibid at n 163.
[167] https://www.ifacts.co.za/news/is-south-africa-soft-on-white-collar-corruption/ (accessed 18-10-2019)
[168] Ibid at n 146 para 149.

on innocent investors where some investors had to resort to financial support from family members. With this in mind, the effects of Ponzi schemes may be felt long after the scheme's collapses and perpetrators of the schemes should be given harsh punishment for the crimes committed by them

Lastly, the time lapse since the first arrest (2002), the first judgment of the High Court (2009) and the hearing before and judgment of the SCA (2016) resulted in a total of 14 years until the final conviction of the accused as well as 14 years until they could start serving their prison sentences. This significant time lapse reflects a failure of the criminal justice system to successfully prosecute Ponzi schemes.

When considering Defencex, to this date there appears to be no significant progress in terms of the criminal case against the perpetrators of the scheme. While the scheme has been declared an illegal deposit taking institution by a High Court, the South African Police Service has not arrested the perpetrators of the scheme, nor have they consequently been charged in formal criminal proceedings. The result is that the perpetrators are potentially free to create new schemes and further entice and deceive individuals into investing in unlawful schemes.

Another Ponzi scheme discovered more recently, called Carmol, should also be considered as a failure to adequately identify a Ponzi scheme in the country. Carmol is suspected of running a Ponzi scheme that held approximately R450 million to R1 billion of innocent investor funds, where investors were promised returns of approximately 95%.[169] The scheme appears to have operated between 2011 and 2014.[170] Inspectors were appointed in September 2014 and a provisional liquidation order was granted in October 2015.[171] The perpetrators of the scheme appeared in court in June 2019 on approximately 11000 charges. It was further expected that around 100 witnesses would testify against the scheme, while many investors have allegedly lost their life savings in the scheme.[172]

As is the case with Defencex, the financial institution who held the accounts of Carmol should be criticized for failing to adequately identify this Ponzi scheme. If the

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[169] https://www.timeslive.co.za/sunday-times/business/2015-01-25-reserve-bank-lashes-carmol-ponzi-scheme/ (accessed 29-09-2019).
[170] https://www.timeslive.co.za/news/south-africa/2019-06-18-durban-couple-accused-in-r1bn-ponzi-scheme-appear-in-court-at-last/ (accessed 29-09-2019).
[171] https://www.gov.za/speeches/update-investigation-carmol-distributors-21-oct-2015-0000 (accessed 29-09-2019).
[172] Ibid at 165.

financial institution adequately discharged its obligations in terms of FICA, and the FIC appropriately referred this matter to a law enforcement institution, then the perpetrators of both Carmol and Defencex may have been stopped sooner, which would prevent further loss of public money. However, if the FIC or the law enforcement institution did not adequately respond to the reports made by the financial institution against the Ponzi scheme in an expedited manner, then the FIC or the law enforcement institution should be held accountable by the appropriate executive authority or parliamentary committee tasked with oversight of the FIC or law enforcement institution. The ability to identify these schemes early can result in millions of Rand being available to innocent individuals.

In addition to the burden that the loss of funds may place on innocent investors, these investors should also consider and be aware of the tax implications in respect of investing with these schemes. In ITC 1814[173] an individual invested funds in an illegal scheme and sought to claim the losses from the scheme as a deduction for the purposes of his income tax return. The court found that in order to claim a loss as a deduction, an individual needs to exercise a degree of control in the business. The loss suffered by virtue an investors' participation in an illegal scheme, will not be considered a loss suffered in the course of acquiring income. In the *MP Finance Group* case,[174] the question before the court was whether deposits made into an illegal scheme fall within the definition of "gross income" as defined in the Income Tax Act 58 of 1962 ("Income Tax Act"). The court found that amounts deposited into a scheme by investors fell within the definition of "gross income", even though the scheme was illegal in nature. This means that when the scheme fails, the scheme will first have to pay income tax to the South African Revenue Service, as deposits from investors are regarding as "gross income" in terms of the Income Tax Act. Pursuant to paying income tax, the liquidators or repayment administrators, tasked with administering the scheme after it fails, may then consider potentially repaying investors. This will result in the scheme having less money to repay investors and thus, investors would potentially lose more money in the scheme.[175]

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[173] ITC 1814 68 SATC 297.
[174] *MP Finance Group CC (In Liquidation) v Commissioner for South African Revenue Service* 69 SATC 141.
[175] Ibid.

Chapter 5:
Conclusion

Ponzi schemes have been around for over 100 years but continue to have a substantial impact on society. There are numerous pieces of legislation that deal with how Ponzi schemes should be investigated as well as repaid in the event there are sufficient funds remaining in the scheme to repay investors. However, given the significant financial impact of these schemes, it may be in the interests of innocent investors as well as the general public to have one consolidated piece of legislation that deals solely with Ponzi schemes. The general public should further be better informed of the schemes, the investigations currently underway as well as the result of investigations. With the second repayment phase of Defencex, the repayment administrators resorted to advertisements in newspapers, distribution of pamphlets as well as text messages in order to assist individuals in coming forward and registering their claims. The repayment administrators further identified locations throughout the country where they would have a physical presence and assist Defencex investors in registering their claims with the repayment administrators.[176] The locations chosen by the repayment administrators were far away from major capitals, such as Giyani in the Limpopo province, Hazyview in the Mpumalanga Province, and Kokstad in Kwazulu Natal.[177] While the Financial Sector Conduct Authority regularly publishes media releases on suspected schemes,[178] the actions taken by the repayment administrators indicate that the rural parts, or less urban areas, of the country should be made aware of the harmful schemes that they may fall victim to. Similar to the actions of the repayment administrators, newspaper advertisements or pamphlets should be handed out in these parts of the country as well. Very little is done by the SARB or the South African government to inform the general public on the warning signs for such schemes, the impact of such schemes as well as how to avoid or report such schemes. Although only three specific schemes were discussed in this dissertation (Defencex, Krion and Carmol), each involved sums close to or exceeding R1 billion. These amounts alone should warrant further action from both the SARB as well as the

[176] Ibid n 142 page 53-54.
[177] Ibid n 142 page 58.
[178] https://www.fsca.co.za/Pages/Media-Releases.aspx (accessed 20-10-2019).

government. From as recently as 2016, there were 26 possible schemes being investigated under the supervision of the SARB. Therefore, a recommendation is that the SARB should establish its own investigative division to conduct inspections into identified institutions. This may reduce the cost as well as the reliance on external service providers. The SARB will then also be able to exercise better control over the investigations and be in a position to act swiftly and decisively where necessary. One of the more questionable aspects raised in this dissertation is the manner in which investors were repaid by the repayment administrators in the Defencex matter. It is arguable that investors should not have been repaid 100% as this may have unfairly prejudiced other investors in the scheme.

There is also a need to speed up the criminal investigation and prosecution of individuals involved in Ponzi schemes. With Krion, 14 years elapsed from the arrest of the perpetrators of the schemes until their appeals were dismissed. With Defencex, no arrests have been made as yet and the perpetrators of the scheme are free to carry on with other potential schemes which may further result in innocent investors losing funds. With Carmol, the criminal case has just begun, and it may be a significant number of years before the perpetrators of the scheme are imprisoned. The general public should see swift and decisive actions against perpetrators of Ponzi schemes which may deter them from entering into such schemes. Harsh punishments on perpetrators may also act as a deterrent for individuals to start Ponzi schemes. This should also culminate in more publicity around these schemes, the investigations thereof as well as the criminal prosecutions. Lastly, financial institutions should be held culpable and accountable for their facilitation of Ponzi schemes. In terms of FICA, they have a duty to identify their clients adequately as well as report suspicious and unusual transactions. If their response, as well as identification processes for these schemes, were more adequate, innocent investors might have lost significantly lower amounts of money.

In cases like Defencex, as well as Carmol, the financial institutions who held the bank accounts of the schemes should receive sanctions from the FIC for their failure to swiftly identify these Ponzi schemes. FICA placed a number of reporting obligations on the financial institutions, but these schemes still operated for significant periods of time where numerous deposits were received from members of the general public. The financial institutions act as a first line of defence to members of the general public and they should strengthen their controls around the identifications of these schemes.

However, as mentioned above, swifter action needs to be taken by the law enforcement agencies to arrest and prosecute perpetrators of the scheme. While these may be difficult issues to address, Ponzi schemes will continue to operate and have such a harmful impact on innocent investors who are lured into these schemes.

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