

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRRETORIA

Case Number: FAIS: 02202/09-10/KZN/1

In the matter between:

ETHEL ELLOUISE BLESSIE & OTHERS 1st Respondent

and

SHEVGEM INVESTMENTS CC t/a RANDSURE BROKERS 1st Respondent

JAMEY RANDALL 2nd Respondent

**DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY
AND INTERMEDIARY SERVICES ACT NO. 37 OF 2002 ('FAIS ACT')**

A. THE PARTIES

- [1] The Complainant is Ethel Elleouise Blessie an adult female person who resides in Dorpspruit.

- [2] The First Respondent is Shevgem Investments CC, trading as Randsure Brokers, a closed corporation duly registered in terms of South African laws with its principal place of business situated at 1 Connor Road Chase Valley, in Pietermaritzburg. The First Respondent is an authorised financial services provider in terms of the FAIS Act, with licence number 18857, represented by Jamey Randall (Randall), a member and key individual of the First Respondent.
- [3] The Second Respondent is Jamey Randall, an adult male, and a key individual of the First Respondent, who shares the same address as the First Respondent.
- [4] For convenience, I refer to the respondents interchangeably as the first respondent and second respondents. In all such cases, the reference to one of the respondents should be construed as reference to both.

About Edwafin Investment Holdings

- [5] At this stage, a brief historical background on Edwafin is merited.
- [6] In the previous Determination in the matter of ***Vinesh Mohanlal v Raj Chutterpaul & Another (CASE NO. FAIS 05679-09/10 KZN)***, the Ombud dealt at some considerable length with the workings of Edwafin Investment Holdings.

[7] Edwafin Investments was a registered financial services provider with FSP number 31990. Edwafin was a venture capital company which was stopped from conducting business and placed under liquidation. They were the majority shareholders in Dynamic Motor Company, Edwabond Capital Options, Rainbow Paints and Edwafin Foundation. Edwafin came to prominence during 2005 with a much publicised debenture offer. It was borrowing money from members of the general public, mainly pensioners and teachers in an attempt to fund its investments.

[8] I deliberately refer to Edwafin and its related companies in the past tense as it is now common cause that they have since been placed under liquidation and their license has been withdrawn by the authorities. However, for convenience in appropriate circumstances, there will be instances where reference is made to Edwafin as if it still exists.

[9] At the outset, I should perhaps mention that, for purposes of this determination, I have only considered issues as set out in the papers that have been placed before me by the parties. I am satisfied that the papers and documentation furnished to this office, particularly by the respondents, are adequate in painting a complete picture of what happened during the rendering of advice by the second respondent. In that regard, I have relied on information furnished to this office by the respondent in answer to the complaint.

[10] I have looked at the situation as it prevailed at the time the respondent rendered financial advice to the complainant. Accordingly, I have largely ignored and not taken into consideration subsequent developments which concerned the fate of Edwafin and its related investments. This determination is based entirely on the documentation and information supplied to this office by the parties, especially the respondent. This information is largely common cause and is not disputed.

[11] It is common cause that Edwafin has not paid interest to its investors since October 2008 and has blamed its difficulties on the global financial crises. Edwafin was placed under provisional liquidation by the Pietermaritzburg High Court in May 2009. The Application for liquidation was brought by one of Edwafin's investors who contributed to the debenture scheme. The Financial Services Board ("the FSB") has since suspended the FSP licence of Edwabond, a subsidiary of Edwafin. According to the FSB, Edwafin issued debentures in terms of the Companies Act and marketed them through Edwabond. Edwabond was thus subject and bound by the provisions Financial Advisory and Intermediaries Services Act ("FAIS Act").

[12] Although the Second Respondent was a licensed financial services provider, he was however not licensed to sell debentures. I will revert later to the significance of the latter point.

B. THE COMPLAINT

Background to the Complaint

[13] In understanding the present complaint, the following factual background is instructive.

[14] Complainant stated that her late father, Mr B.R Smith, (“the complainant’s father”) had been employed by the Umsunduzi Municipality for a period of thirty (30) years, and was due to go on pension at the attainment of the age of sixty five (65).

[15] In September 2007 at the age of 62, the complainant’s father suffered a stroke. He was subsequently diagnosed with stage four cancer.

[16] After diagnosis, the family was advised by the doctors that the complainant’s father would only live for a maximum of 18 months after the operation. He had to undergo new treatment. This treatment was aimed at prolonging his life for a few more months. The family, including the Second Respondent decided that, given his deteriorating condition, the complainant’s father would not be told that he had only 18 months to live.

[17] In December 2007 when the complainant’s father’s health had deteriorated further, he was advised by the second respondent to take an early package and invest his money.

[18] The complainant's father's condition deteriorated further and he started experiencing memory loss and his walking pace had become relatively slower. He could no longer dress himself properly. He put his shoes the wrong way and could not button his shirts properly or fasten his belt. Indeed, it is common cause that the complainant's father had become confused about the time of the day and could no longer read the time.

[19] This description of the complainant's father's condition gains some importance when one considers the fact that financial advice was rendered to him at that time by the second respondent. I should mention though that for his part, the second respondent asserts that when he rendered financial advice the complainant's father was still able to appreciate what was happening so much that he could still drive himself around. In my view, nothing turns on this dispute and the reason will become clear when one discusses the suitability of the product, risk assessment and due diligence.

[20] In February 2008 the second respondent invested R 600 000 of the complainant's father into Edwafin Investment Holdings. The second respondent invested a further R 300 000 of the complainant's father into Dynamic Wealth. The second respondent had assured the complainant's father that he would live comfortably from the interest of the capital amount invested. In that regard, the second respondent represented that the interest would be more than interest normally yielded by financial institutions. However, the complainant's father regrettably passed away on the 13th May 2008 before any interest had been paid out to him.

- [21] After the death of the complainant's father, the second respondent issued debenture certificates to the complainant and other children of the deceased who are not party to the present complaint.
- [22] The complainant was issued with Debenture certificate No. J 124, and she got 100 debentures.
- [23] Shortly after the death of the complainant's father, the second respondent approached the family and advised that they were each beneficiaries of debentures to the value of R 100 000 each. The second respondent told the complainant and her sisters that the capital amount would be paid out to each one of them after five years and that in the interim they would each be receiving interest which would be paid on a monthly basis.
- [24] I should pause and mention that there are separate complaints concerning the other family members which are subjects of different determination. Suffice it to mention that each of these complaints is dealt with on its own merits, I merely refer to the other family members for the purpose of completeness.
- [25] Indeed, the complainant and her sisters did receive their interest in September 2008. However, at the end of October 2008 the complainant received an SMS message from Edwafin Investment Holdings informing her that Edwafin was experiencing problems with their electronic payments and

that a cheque would be posted instead. As promised, the complainant received the cheques for the months of October and November 2008. However, the cheques could not be honoured on account of insufficient funds. After several desperate attempts to follow up on the dishonoured cheques, complainant and her sisters received letters from Edwafin explaining the company's cash flow problems.

[26] When it became clear that the complainant would not be recovering any of her money, she then lodged a complaint with this Office.

C. RELIEF SOUGHT

[27] The complainant seeks payment from the respondents in the amount of R 100 000 together with interest.

D. INVESTIGATION

[28] Upon receipt of the complaint, on 27th October 2009 this office sent out correspondence requesting the second respondent to resolve the complaint directly with the complainant. Furthermore the respondent was informed that there were other similar complaints which had also been lodged by a number of his clients.

[29] When the parties failed to informally resolve the matter, the complaint was then accepted for formal investigation. Thereafter a notice in terms of section

27(4) of the FAIS Act was issued and the respondent was requested to submit his response together with all other necessary documentation in terms of the Act.

E. THE RESPONSE

[30] The second respondent submitted his response and in the process he also furnished this office with supporting documentation.

[31] In his response, second respondent stated that in 2007 he began assisting the complainant's father in maturing his provident fund. He states that he advised the complainant's father to invest with Edwafin because at the time Edwafin was giving very competitive interest rates as opposed to a guaranteed income from a guaranteed fund.

[32] The second respondent submitted that he conducted a thorough due diligence of Edwafin's audited financial statements before investing the complainant's father's funds.

F. RESPONDENT'S RECORD OF ADVICE

[33] As part of his response to this office, the respondent submitted record of advice in terms of section 9 of the General Code which requires all FSPs to maintain and keep proper records of advice rendered to clients. In this connection, the respondent submitted these records in compliance with the

Code and as requested by this Office. It is perhaps appropriate to deal with the important parts of the record of advice as submitted by the respondent.

[34] In what follows below, I deal with relevant portions of the record of advice.

[35] Section C is headed "*Products Considered*", and these are listed as "*Edwafin and Dynamic Wealth, Discovery and Liberty*".

[36] The next section is Section D and is headed "*Initial Recommendation/ Advice & Motivation*".

[37] Under the column "Motivation" which sets out the reasons for recommending EDWAFIN, the following entry is made:

"as they are giving Mr. Smith 20% in interest on R600 000 and this will add up to R10 000 pm which is what Mr. Smith earned just before he fell ill."

Original Quotation

[38] Similarly, under Dynamic Wealth, the reason for recommending DYNAMIC WEALTH is set out as follows:

"Money market, as they are giving the highest interest and the money R300 000 is available on two days' notice."

Original Quotation

[39] Section E is entitled: *“Important information Highlighted to Client”*. Under this heading, the following entry is noted:

“EDWAFIN is considered to be moderate to high risk as it is an unsecured debenture. However, given Mr. Smith’s poor prognosis as he was diagnosed with a very rapid growth and terminal illness (cancer) it is recommended that he receives the highest income as his medical expenses and living arrangements would be financially taxing and would be difficult to maintain on less monthly income than he was used to.”

Original Quotation

[40] A striking feature of the respondent’s record of advice and his response to this office is that there does not appear to have been any explanation given on the nature of the risk associated with the Edwafin investment. The entry made in the record of advice simply vaguely refers to the Edwafin investment as “moderate to high risk” investment. However, the objective fact which should have been conveyed to the complainant’s father was that as an unsecured debenture, the Edwafin investment was by its very nature a high risk investment. It was simply disingenuous and misleading to even suggest that the Edwafin product was “moderate” in any way. The second respondent does not seem to have paid any attention to the viability of the Edwafin investment. The high risk nature of this investment is further compounded by the lack of any track record of the company itself which does not seem to have been examined by the respondent.

[41] In my view, if the product sold to the complainant's father was a high risk product, then the nature, history and track record of the company which extolled the virtues of that product ought to have come under the financial services provider's (in this case the second respondent's), scrutiny. This process of examining the track record of the company, the suitability and viability of the financial product would have naturally been done in the ordinary course of conducting due diligence.

[42] Due diligence simply means that the financial services provider examines the company and the product it sells beyond the company produced marketing material. Thus among other basic things required when conducting due diligence, the financial services provider checks on the legitimacy of the company to see whether it is properly registered and licensed by the authorities, establishes its history, examines the structure of that company to see whether it adequately affords protection to investors, looks into its directors, and examines the viability of the product sold and see if it is compatible with the needs of the investor. It goes without saying that there is a duty on the financial services provider to carefully examine the extravagant claims made on the probable success of the product. In that regard, the financial services provider ought to examine extravagant claims which promise huge returns and determine if these are attainable, judging from the underlying economic activity. There are several other factors that must be taken into account, and it is not necessary to list them all here as they are set out in the FAIS Act.

[43] In the present matter, the Edwafin investment promised a return of 20% interest which was out of kilter with the single digit interest promised by established financial institutions. No information was furnished as to how this extravagant interest would be raised. Instead the second respondent simply accepted this claim without more.

[44] A simple look at the Edwafin scheme and the extravagant claims made in its several glossy brochures would have raised the suspicion of any reasonable financial services provider that they could be dealing with a pyramid scheme. Indeed Edwafin investment bore all the hallmarks of a pyramid scheme. Stripped of the facade of its legality in the form of licensing, the substance of Edwafin indicated that the scheme was clearly unworkable. It was therefore not in the interest of the complainant's father to invest such a substantial portion of his investment in such a high risk scheme.

[45] What is more, the investment of the complainant's father's money into Edwafin was clearly at variance with the results of the results of the risk analysis conducted during the course of rendering financial advice. The results of the risk analysis had indicated that the complainant's father was a moderate investor. To be sure, the risk tolerance of the complainant's father placed him out of bounds for such high risk investment as Edwafin. However, for reasons that are entirely at odds with these risk profile results, the second respondent went on to advise the complainant's father to invest in Edwafin.

[46] Clearly, the entire exercise of going through the risk analysis was a mere formality performed to comply with the formal requirements of the FAIS Act. There was no analysis of the results and what the implications of investing in such high risk product entailed. In a word, the substance of the Edwafin product was clearly not suited to the needs and circumstances of the complainant's father.

[47] In breach of the FAIS Act and the General Code, the second respondent completely ignored the results of the risk analysis and invested the complainant's father's money into the high risk Edwafin.

[48] The following passage from the second respondent's response furnished to this office is instructive and merit further consideration. In a letter dated 05th January 2010, the respondent stated as follows:

"My reason for advising Mr Smith to invest with Edwafin at that time is that they were giving 20% p.a interest as opposed to a guaranteed income of 10% in a guaranteed fund."

"On my perusal of Edwafin's audited financials, it reflected that they were in a good financial position as they made a substantial profit despite paying out high interest to debentures holders and thus I gathered that the business was sound as this reflected on their Audited Financial Statements and therefore I did not suspect any foul play."

Original Quotations

[49] The second respondent's claim that he had conducted due diligence by examining the audited financial statements and books of Edwafin cannot be correct. In the first instance, no proof of such audited financial statements was ever made available to the public. Nor could the respondent furnish this office with any such proof. No proof was furnished of any substantial profit having been made by Edwafin, nor did any such profit ever take place. The objective fact remains that Edwafin had no previous trading history or track record.

[50] The obvious starting point for any meaningful due diligence is the examination of the company's prospectus. In the present case, the second respondent did not bother to check the company's prospectus but instead relied on extravagant claims contained in the glossy marketing material.

[51] Although it is commendable that the second respondent maintained and kept proper records of financial advice rendered, he did not seem to have paid any heed to the various provisions of the Act and the Code.

G. THE ISSUES

[52] The main issue for consideration is whether the respondent gave proper advice to the complainant's deceased father. In that regard, the quality of advice furnished by the respondent is readily ascertainable from the record of advice which is required to be kept by FSPs in terms of the Code.

[53] Inextricably linked with the quality of advice furnished by the respondent, is the question as to whether the respondent conducted the necessary due diligence on the product he invested the complainant's father's money. Of course all these issues require, as a starting point, an examination of whether the respondent was competent to sell the product he recommended to the complainant's father.

H. FINDINGS

[54] It is common cause that the respondent was not licensed to sell debentures. In his response, the second respondent himself conceded that his license did not include the selling of debentures; however, he thought the financial product he sold to the complainant's father was the best choice as it yielded higher returns than conventional investments.

[55] Given the unusually high returns the product promised, the second respondent ought to have carefully examined the viability of the product and determined whether the extravagant claims made were attainable. Had the second respondent done that he would certainly have come to the realisation that the huge returns promised were certainly not practical or economically sustainable.

[56] In any event, the product sold to the complainant's father was an unsecured debenture for which the second respondent possessed neither the skill nor the training to sell.

- [57] The second respondent was in breach of the FAIS Act in selling a financial product for which he was not licensed.
- [58] The FAIS Act and the Code place a duty on the financial services provider (FSP) to act with due skill, care and diligence. This duty ensures that FSPs act with responsibility and that the consumers are adequately protected from financial products which may be to their detriment. It is only those financial products which stand to benefit the consumer which should be sold to members of the public. In failing to conduct proper due diligence of the company and its product, the second respondent failed in his duty to act with care and skill required of an FSP.
- [59] The integrity of the financial services can only be protected when FSPs act with the care and skill as set out in the FAIS Act and the Code. Regrettably, the second respondent failed to disclose his limitation (namely, that he was not licensed to sell unsecured debentures unsupervised) to the complainant and her father. In that regard, the second respondent sold a product he clearly did not understand. That being the case, the second respondent would not have been in a position to examine the product and properly advise the complainant's father of any shortcomings in the financial product on offer because he was none the wiser.

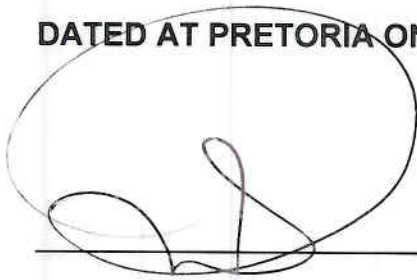
[60] The above being the case, the second respondent was in breach of the FAIS Act and the Code when he advised the complainant's father to invest in Edwafin. That breach of the Code resulted in the loss of the complainant's investment made into Edwafin.

I. THE ORDER

In the result, I make the following order:

1. The complaint is upheld.
2. The first and second respondents are jointly and severally liable for the payment of the complainant's money.
3. The first and second respondents are jointly and severally liable, the one paying and the other one being absolved, and are ordered to pay to the complainant :
 - 3.1 The amount of R 100, 000.00
 - 3.2 Interest on the amount of R100, 000.00 at the rate of 15, 5% per annum from a date seven (7) days from date of this order to date of final payment;
4. The first and second respondents are ordered to pay the case fee of R1000, 00 to this office within thirty (30) days of date of this determination.

DATED AT PRETORIA ON THIS THE 25th DAY OF JANUARY 2012.

A handwritten signature in black ink, consisting of several loops and a long horizontal stroke, positioned above a solid horizontal line.

NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS

