IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 03808/11-12/ FS 1

In the matter between

CHRISTIAAN FREDERICK SCHEEPERS **Complainant**

and

JOSE FRANCISCO CASTRO **Respondent**

DETERMINATION IN TERMS OF SECTION 28 (1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT 37 OF 2002 ('THE ACT')

A. INTRODUCTION

[1] Complainant made two investments in Sharemax, one in Zambezi Retail Park (Zambezi) in an amount of R100 000 and the second in The Villa Retail Park (The Villa) in an amount of R790 000. The investments were made through the respondent and subsequently the funds were lost after Sharemax collapsed. Complainant then filed a complaint with this office.

B. THE PARTIES

[2] Complainant is **CHRISTIAAN FREDERICK SCHEEPERS** a farmer residing and farming in Vrede in the Free State. At the time of making the investment he was 55 years old; he is presently 67 years old.

[3] Respondent is **JOSE FRANCISCO CASTRO** a licensed financial services provider (FSP) with FSP No. 33526; who resides in Kuhn Street Vrede, Free State. At all material times, respondent was acting as a representative of FSP Network (Pty) Ltd t/a USSA, in terms of Section 13 of the Financial Advisory and Intermediary Services Act of 2002 ("the Act").

C. THE COMPLAINT

[4] On the 3 December 2008, complainant invested R100 000 in Zambezi. A second investment was made on the 27 August 2009 in The Villa, in an amount of R790 000. Complainant is extremely upset at what happened to his investments and alleges as follows:

a) Respondent merely handed out brochures which turned out to be "misleading, false and untrue". Complainant states that respondent advised him with incorrect information and did so deliberately. Respondent falsely informed complainant that the buildings in question were already leased by tenants and that there were also purchase agreements in place.

b) Complainant believes that there was a duty on respondent to study the prospectus and draw his attention to the risks in the investment. Complainant points out that respondent merely relies on the risks disclosed in the prospectus to absolve himself from blame.

c) Complainant points out that respondent as a professional advisor with the requisite knowledge, is responsible for the loss of complainant's capital and interest.

d) Complainant avers that on two occasions cash was handed to respondent to invest. Complainant claims that this was illegal.

e) Complainant seeks return of his capital and interest.

[5] From documents provided to this office it appears that the investments were not made in two full amounts. Instead it appears that the investments were made in various tranches, comprising cash and cheques, over a period between 2008 and 2010. The significance of this appears later in this determination.

[6] The complaint was referred to respondent and his response was requested. Respondent was also advised to attempt to settle the matter with complainant and he had a timeframe of 6 weeks to achieve this. However, respondent notified this office that it was not possible for him to meet with complainant as the latter had threatened him. Nor did respondent suggest any basis for settlement which this office could have assisted the parties to achieve. I therefore accept that the matter was not capable of being settled.

D. THE RESPONSE

[7] Respondent provided the office with a written response, supported by various documents. Respondent also responded to complainant's attorneys and the contents of that response will also be taken into account.

Representative

[8] The first thing I want to deal with is the license status of respondent. The documentation shows that respondent acted as a representative of FSP Network (Pty) Ltd t/a USSA. In a letter to this office, respondent states as follows:

a) He confirms that as an intermediary he was acting as a representative under FSP Network;

b) The reason for the above arrangement was that “the necessary experience required by the FAIS Act was not achieved yet”;

c) As a representative he acted under the instructions of the key individual of the FSP and the Key individual is the accountable entity; and

d) As a representative, respondent completed the applications “as per the prospectuses and the instructions of the key individuals”.

[9] In effect, respondent attempts to avoid accountability by hiding behind his representative status, he also attempts to shift blame to the key individual in USSA.

[10] As a representative, respondent was obliged to conduct himself in terms of Section 2 of the Act, he had to render financial services to complainant honestly, fairly, with due skill, care and diligence, and in the best interests of client. I also draw attention to the provisions of the following sections of the Act: 13 (1) (b) (i) (bb); 13 (2) (a) and (b) and Section 7 (1). As a Section 13 representative, respondent as an FSP, enjoyed no exemption from the Act and The Code.

Disclosure Document

[11] On each occasion that complainant invested an amount of money, one of the documents he signed is a “Disclosure Document” prepared by Sharemax or USSA which complainant is obliged to sign and date and must be submitted to USSA by the

representative. A number of these documents were signed and dated by complainant. The purpose of the document is to disclose the fact that the FSP is acting as a representative of USSA. The document then sets out a number of terms and conditions.

[12] The first difficulty I have with this document is that it is in English. The complainant is Afrikaans. Secondly, the document is not user-friendly and is presented in very small print with the minimum spacing and will be impossible for an elderly Afrikaans speaker to read and understand it. There is no evidence on record that respondent explained this document to complainant in Afrikaans nor is there any evidence that an Afrikaans version was provided.

[13] This document, significantly, sets out the disadvantages and risks associated with the product. It also informs the investor that as a USSA representative, respondent was only authorised to market Sharemax and no other product. It is not disputed that respondent did not provide complainant with other or alternative investment choices.

[14] I deem it necessary to summarise the risks and warnings in this document:

a) That even though the representative may provide advice, the ultimate decision to invest rests solely with the investor;

b) There is a risk that capital and income could not materialise;

c) The ability to transfer the shares and debentures is restricted by the absence of a market for those shares;

d) The company is newly formed without any trading history which can be used to evaluate the likely performance of the product supplier and its ability to achieve its objectives;

e) In cases where loan finance is advanced to a developer, there is a risk that the developer may default on its obligations or produce insufficient profits to make payments of returns or capital or other amounts due to the investor;

f) There is a “substantial risk” that the investor may not be able to sell his shares/debentures should the investor chose to do so in future;

g) The investor declares that they understand that they must take “particular care” to consider whether the product selected is appropriate to the investor’s needs, objectives and circumstances;

h) The repayment of capital and income is not guaranteed. The performance of the property syndication investment is not guaranteed; and

i) The units/shares are unlisted and should be considered as a risk capital investment.

[15] This document was presented to complainant for signature by respondent. I must therefore accept that respondent had read and understood the contents of this document. I also accept that respondent underwent training in the product and all the relevant documents; such training being provided by USSA.

[16] As a licenced FSP and as a representative of USSA, respondent was obliged to comply with The Act and the Code. Respondent was not exempt from this obligation and duty towards complainant just because he was a representative of USSA.

[17] As stated above, this disclosure document actually states that this investment is high risk and investors could lose their capital. There is no record that respondent actually took complainant through this document, in Afrikaans, and explained all the risks. I also question the fact that, having understood that this was a high-risk investment, what motivated respondent to deem this a suitable investment for complainant? How was a

recommendation to invest in such a high-risk investment in the best interests of complainant? Respondent provided no rational explanation for this.

[18] I must make a relevant observation. Complainant is a farmer and is certainly not sophisticated with regard to finance. He also appears to be poorly literate or semi-literate, this can be seen from the manner in which he writes, which is very elementary and indicative of a high level of illiteracy. He certainly would not have been able to properly read, let alone understand a document written in English. He also took money to the respondent as and when he was able to. For instance, he sold cattle for cash or maize, then handed the cash to respondent. He did this on a number of occasions and handed over amounts from R10 000 to R20 000. He was totally reliant on respondent's advice. On the probabilities, had respondent made a full and frank disclosure of the nature of this product, or even explained the contents of the disclosure document, complainant would not have invested.

Civil Case

[19] Respondent explains that complainant already tried to make a civil case against him. It is not disputed that complainant instructed an attorney to write to respondent claiming repayment of his capital. However, no court action or application was ever instituted by complainant against the respondent. Accordingly, this office has jurisdiction to investigate the complaint.

Introduction to the Product

[20] Respondent placed an advertisement in a local newspaper about the Sharemax product. Responding to the advertisement, Complainant's spouse came to the office and "*the advisor and Mrs Scheepers only quickly discussed this product and took a brochure from us*". This statement is vague and unhelpful and no details are provided about what was

discussed. The provision of a brochure does not amount to any explanation about the product.

Explanation about the Product

[21] Complainant then came to see respondent. According to respondent, they "*discussed it thoroughly*" and the way they explained the product was that it was like buying property. I now quote what the respondent states*: "The risks are about the same, because if property in your name is not sold, you cannot claim the funds in any manner, the building or property needs to be sold. If you rent it out, then you receive income. If the lessee does not pay his rent, then no income is generated".*

[22] On respondent's own version, they misrepresented this investment to complainant. Firstly, the disclosure document, set out above, contradicts this explanation and discloses the real and substantial risks in this investment. Nor do the prospectuses describe the investment in these terms. I accept that respondent read and understood the disclosure document and the prospectuses. Respondent must have known that Zambezi and The Villa did not own any property, there were no buildings with rental income and investors' funds were to be used, at the discretion of the directors, to make unsecured loans to the developer. The investors' capital was placed at risk immediately after the cooling off period. On respondent's own version this was not explained to complainant.

[23] Then respondent states as follows: *"The client's investments was done as a direct request from them after receiving the information as per our discussion and the brochures and prospectuses given."* Again, respondent is vague about what was discussed and makes an attempt to distance himself from client's decision to invest. On respondent's own version the investment was made as a result of financial advice

provided by the respondent. The respondent was bound to provide that advice in terms of the Act and The Code. I note that, apart from providing this office with the Sharemax forms and documents, no record of advice was provided.

Brochures and Prospectuses Misleading

[24] Respondent denies that the brochures and prospectuses were misleading. The only reason offered is that "*this is hardly possible as it was registered with the Registrar and FSB".* Respondent must have known that neither the Registrar nor the FSB carry out product approval. The onus is on the FSP to read and understand the prospectus and be able to explain the product to client. In fact, the prospectus does make a disclosure of the true nature of the product and the risks associated with it. There is no record of advice nor any other evidence that respondent diligently took complainant through the prospectus and explained the nature of the investment and the risks inherent in it. In the circumstances of this investment as explained above, respondent cannot merely rely on the complainants own reading of the prospectus.

[25] Respondent similarly denies misleading complainant that Sharemax had already leased the buildings and had purchasers for the buildings. Respondent explains that they did not lie to complainant as they were actually informed by Sharemax that "*there was lease and sale contracts signed on the property. … I was told that the contracts are with Weavind and Weavind, the attorneys for Sharemax".* There is no evidence that, if indeed Sharemax so informed respondents that they diligently checked with the attorneys and called for the leases and sale contracts. Besides, this is contradicted by the prospectus which informs that Sharemax did not own any property and the shopping malls were still under construction and being funded from investors' money. On respondent's own version, they misled the complainant.

No Liability

[26] Respondent states that they cannot be held liable for complainant's loss as they did not take his money and interest was not guaranteed. This is a further evasive response. It is not complainant's case that respondent took his money. His complaint is that he made a poor investment as a result of bad advice from respondent.

Sharemax and USSA

[27] Respondent states that complainant signed all the documents to place the investment required by Sharemax and USSA who "*handled the disclosures and compliance".* Respondent cannot distance himself from the fact that complainant signed the documents on his advice, and it is patently clear that complainant relied entirely on the advice of respondent. Both Sharemax and USSA expressly stated that they did not provide any financial advice to investors. This is factually correct.

SARB

[28] Respondent states that he was not expected to reasonably foresee that the SARB would intervene thereby causing the collapse of Sharemax. This does not assist respondent. The test is not about whether or not he could have foreseen the actions of the Reserve Bank; the test is whether or not his advice was appropriate at the time the investment was made.

[29] Respondent also states that it was only after the SARB made a directive that complainant demanded return of his funds. Respondent is of the view that funds can only be released after the SARB withdraws the directive and investors have to wait to see how the Section 311 scheme works. This reflects respondents misunderstanding of what happened with the SARB and subsequent provisional liquidation of Sharemax. Respondents must have known that there was no prospect of complainant recovering

his capital from Sharemax. The risk to capital, disclosed in the prospectus and disclosure document, had materialised.

No Similar Product

[30] According to respondent, at the time of making the investment, there were no other comparable products to offer complainant. He also adds that when other investments were mentioned, complainant indicated that he was not interested and was happy with the investments made through Sharemax. Firstly, there is no record of advice to confirm this. Secondly, even if this is true, respondent was still under a duty to make full and frank disclosure about the Sharemax product, including the fact that it was a high-risk investment. It is not likely that respondent offered complainant alternative products as his agreement with USSA tied him down to market only the Sharemax product.

E. THE ISSUES

[31] The issues for investigation and determination amount to this:

a) Did Respondent, in advising his client, conduct himself in terms of the General Code, in particular section 2; and

b) Did the Respondent actually comply with the provisions of the following sections of the Code:

Section 3 (1) (a) (i) and (iii) ; Section 7 (1) (a); Section 8 (1) (a) and (c) and Section 8 (2).

c) Did respondent act in breach of his contract with Complainant; and

d) Did Complainant suffer loss and if so, what was the cause of the loss and the quantum thereof.

F. APPLICATION OF LAW

[32] Bearing in mind the facts found to be proved and the conclusions to be drawn from them, the following findings can be made:

a) Respondent failed to act honestly, fairly, with due skill, care and diligence;

b) Respondent failed to act in the interests of his client and by his conduct, he compromised the integrity of the financial services industry. Respondent contravened section 2 of The Code;

c) Respondent failed to provide full and frank disclosure of all the material information about the Sharemax product;

d) Respondent failed to enable complainant to make an informed decision. Therefor Respondent contravened section 7 (1) (a) of The Code; and

e) Respondent failed to seek relevant information from complainant and failed to provide appropriate advice. Respondent failed to identify a product that was appropriate to complainant's risk profile and financial needs. Again the conclusion is that Respondent contravened section 8 (1) (a), (b) and (c) of The Code.

[33] The fact that respondent was in breach of the Act and The Code does not mean that he is therefore liable for complainant's loss. There needs to be a breach of contract as well as a claim in delict.

[34] Further, this office as well as the Board of Appeal have consistently found that where a client makes an investment pursuant to advice rendered by an FSP, there exists a contract between FSP and client. It is an express, alternatively implied term of the contract that Respondent, in providing the advice, he complies with the provisions of the Act and The Code. For reasons already stated, respondent was in breach of this term. A consequence of this breach was the loss of complainant's capital.

[35] In a number of recent judgements in the high court, it was found that complainant's claim under circumstances as these is one in delict based on negligence. Once it is established that the respondent gave financial advice, two questions arise:

a) did the respondent comply with his legal duties towards the client; and
b) whether in terms thereof the respondent acted wrongfully and negligently.

[36] A reasonably competent FSP in the position of respondent would have done the following:

a) Carried out diligent research to become familiar with the nature of the Sharemax product he intended to sell, respondent should have received training and instruction about the product as part of his appointment as a representative in terms of Section 13;
b) Would have found out that the Zambezi and The Villa promotions were completely different to all the other property syndications Sharemax had promoted in the past;
c) As a basic step he was expected to read and understand the prospectus and the annexures thereto and explain it to complainant in plain language;
d) Made a point of understanding how Sharemax intended to pay his commission and investor's returns bearing in mind that Sharemax owned no assets and enjoyed no trading history and did not have any independent means of making these payments (these facts are stated in the prospectus). Significantly, respondent had a duty to explain this to complainant;
e) Would have noticed that contrary to what was initially stated in the prospectus, investor funds will not be kept in trust but will be paid out to the developer at the discretion of the promoter (this too is stated in the prospectus as well as in the disclosure document), this had to be explained to complainant;

f) Respondent knew that investor funds were going to be lent to the developer at an interest rate of 14% and that there was no security for the loan (stated in the prospectus), and he was under a duty to inform complainant about this;

g) Would have called for and read the Sale of Business Agreement between the promoter and the developer (the agreement is in the schedules and annexures to the prospectus). Had he done so respondent would also have found out that 3% of the investor's capital was being paid out as "agents commission" and that was even before the money was lent to the developer, 10% was deducted by the promoter as administrative fees. The 14% interest payable by the developer was paid out of the investor's capital. A reasonably competent FSP would have worked out that after 27% of the capital was deducted, investors were still going to be paid 12% interest on 100% of their capital. This was certainly not sustainable. These facts are stated in the prospectus. Respondent failed to inform complainant of this;

h) Would have noticed that the shares will not be easy to dispose of, the promoter offered no assistance in disposing of the shares and the onus was placed on the investor to find a buyer (also stated in the prospectus and the disclosure document);

i) Would have explained the risks in the investment as stated in the disclosure document.

[37] Clearly by failing to draw complainant's attention to the above information, respondent failed in his legal duties to his client.

[38] The respondent also acted wrongfully and negligently; he was under a legal duty to make a disclosure of these facts to complainant. Respondent acted negligently in not making

full and frank disclosure thereby depriving complainant of the right to make an informed decision.

[39] The respondent must be judged by the standard of a reasonably competent FSP in the same circumstances. Therefore the inquiry must progress to the next question: would a reasonably competent FSP have advised complainant differently. It is overwhelmingly clear that a reasonably competent FSP would have read and understood the prospectus and would not have advised complainant to invest in a manifestly high-risk investment where there was a prospect of losing all the capital. The SCA in Durr v ABSA Bank, Schutz JA stated as follows:

"The reasonable person has no special skills and lack of skill or knowledge is not per se negligence. It is, however, negligent to engage voluntarily in any potentially dangerous activity unless one has the skill and knowledge usually associated with the proper discharge of the duties connected with such an activity."

"Liability *in delict arises from wrongful and negligent acts or omissions. In the final analysis the true criterion for determining negligence is whether in the particular circumstances of the conduct complained of falls short of the standard of the reasonable person."*

[40] A reasonably competent FSP, at the time of providing financial advice to client, would be expected to do the following:

a) ensure that he read and understood the Code;

b) understands that he is obliged to comply with the code in providing financial advice;

c) understands the nature of the financial product/s he is recommending to client;

d) understands the product so that he is in a position to explain it to client in plain language;

e) accepts that he is obliged to make a full and frank disclosure of all the available information about the product;

f) understands that he is obliged to ensure that his client will be in a position to make an informed decision; and

g) accepts that he must recommend a product that is suitable for client bearing in mind the latter's financial circumstances and tolerance for risk.

This amounts to the general level of skill and diligence possessed by licensed FSPs.

[41] Accordingly, and in the circumstances, the respondent was under a legal duty of care to comply with his obligations. An omission to comply, in the circumstances, amounts to a negligent breach of the duty of care. A reasonably competent FSP, at the time of providing advice, should reasonably be expected to foresee that in the event of a breach of the aforesaid legal duty of care client will suffer harm. That harm will be the possible loss of client's capital. The precise or exact manner in which the harm occurred need not be foreseeable, the general manner of its occurrence had to be reasonably foreseeable. For example, advice to invest in a risky investment must result in a reasonable foreseeability that the investment could be lost in the near future. It is not a question of performance of the product but the realisation of existing risks in the product. The reasonable foreseeability must become even more clear where the product provider actually warns the FSP of the risks in the product. As in this matter, the prospectus and disclosure documents stated the risks in the Sharemax investment. The respondent was aware of these risks; but nevertheless, advised complainant to invest his funds.

[42] Respondent's conduct fell short of that of a reasonably competent FSP and Respondent was the factual and legal cause of complainant's loss.

See Sea Harvest Corporation (Pty) Ltd and Another v Duncan Dock Cold Storage (Pty) Ltd and Another 2000 (1) SA 827 (SCA).

I refer to the following decisions:

OOSTHUIZEN v CASTRO AND ANOTHER 2018 (2) SA 529 (FS);

CENTRIQ INSURANCE COMPANY LTD v OOSTHUIZEN AND ANOTHER 2019 (3) SA 387 (SCA);

ATWEALTH (PTY) LTD AND OTHERS v KERNICK AND OTHERS 2019 (4) SA 420 (SCA) at p529.

G. QUANTUM

[43] Respondent invested R100 000 in Zambezi and R790 000 in The Villa. Respondent is liable for complainant's loss of capital.

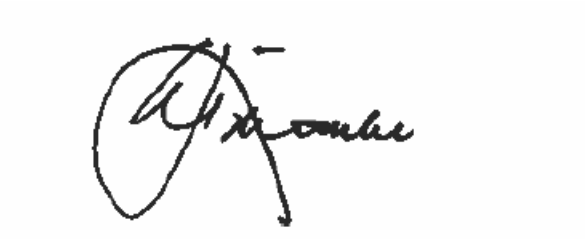
H. THE ORDER

[44] In the premises, I make the following order:

1. The complaint is upheld;
    1.1 Respondent is ordered to pay complainant an amount of R100 000 in respect of the Zambezi investment;
    1.2 Respondent is ordered to pay complainant an amount of R790 000 in respect of The Villa investment;
2. Interest is payable at 7,75% per annum on each capital amount from a date 14 days from service of this order to date of payment.

3. Once the payment is made as ordered, the complainant are to cede their rights in respect of any further claims to these investments to the respondent.
4. Should any party be aggrieved with the decision, leave to appeal is granted in terms of section 28 (5) (b) (i), read with section 230 of the Financial Sector Regulation Act 9 of 2017.

DATED AT PRETORIA ON THIS THE 13th DAY OF OCTOBER 2020.



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ADV NONKU TSHOMBE

OMBUD FOR FINANCIAL SERVICES PROVIDERS