IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS PRETORIA

CASE NUMBER: FAIS 00118/11-12 FS 1

In the matter between:

CORNEL ERASMUS **Complainant**

and

DOVETAIL TRADING 509 CC **First Respondent**

HERMANUS SP LOMBAARD **Second Respondent**

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

A. INTRODUCTION

[1] The complaint in this case arises from a failed investment made by complainant into a property syndication known as Sharemax The Villa Retail Park Holdings Limited,[1] (The Villa), following the advice of respondents. The basis of the complaint is that respondents advised complainant to invest in a high-risk scheme that was incompatible with her personal circumstances at the time.

B. THE PARTIES

[2] Complainant is Cornel Erasmus, an adult female whose full particulars are on file with the Office.

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1 Registration number 2008/017207/06

[3] First respondent is Dovetail Trading 509 CC, a close corporation duly registered in terms of South African laws, with registration number 2002/082361/23. The Regulator's records confirm first respondent's address as 41 Niel van Loggerenberg Crescent, Universitas Ridge, Bloemfontein. First respondent is an authorised financial services provider in terms of the Financial Advisory and Intermediary Services Act, (Act 37 of 2002) as amended, (the Act), with license number 19653.

[4] Second respondent is Hermanus Stephanus Phillipus Lombaard, an adult male representative and key individual of first respondent. Second respondent's address is the same as that of first respondent.

[5] At all material times, second respondent rendered financial services to complainant.

[6] In this determination, I refer to first and second respondents collectively as respondent. Where appropriate I specify.

C. BACKGROUND TO SHAREMAX

[7] The background to Sharemax Investments (Pty) Ltd, (hereinafter referred to as Sharemax) has repeatedly been canvassed in several determinations of this Office. I refer in this regard to the determination of *Carol Charlotte Van Zyl v Johannes Christian Mostert*[2].

D. INFRACTIONS OF NOTICE 459

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[2] FAIS 02955/11-12/ KZN 1, paragraphs 5-13.

[8] For reasons that will emerge later in this determination, it is necessary to make a few comments with regards to The Villa investment.

[9] On 30 March 2006, the Minister of Trade and Industry, acting in terms of section 12 (6) of the Business Practices Act, (Act 71 of 1998) published Notice 459 of 2006 (Notice 459 or simply the Notice) in Government Gazette No 28690. The notice came into effect on 30 March 2006 following the Minister's consideration of a report by the Consumer Affairs Committee. It states in the Notice that the Minister is of the view that an unfair business practice exists, which is not justified in the public interest[3]. In order to counter the business practice, the Minister exercised his powers by publishing the regulations as evidenced in the Notice.

[10] In terms of section 2 (a) of the Notice, investors shall be informed, in writing, that all funds received from them prior to transfer/finalisation shall be deposited into the trust account of a registered estate agent, a legal practitioner or a certified chartered accountant and provided that such trust account is protected by legislation. Individual investors are to be given written confirmation thereof. It shall be clearly stated who controls the withdrawal of funds from that account. Such an account shall be designated " XYZ Attorneys/auditors/estate agents Trust Account- the xyz syndication".

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[3] a) the business practice whereby the prescribed information, in part or otherwise, as stipulated in Annexure "A" is withheld by promoters or their representatives from investors or potential investors in public property syndication schemes; and or

b) any term, condition or provision in the disclosure document that excludes, limits or purports to exclude or limit the legal liability of the syndication promoter towards the investor in respect of any malicious, intentional, fraudulent, reckless or a grossly negligent act of the syndication promoter, his employees, representatives, contractors or subcontractors or any other person used by the syndication promoter or recommended by him to the investor.

[11] In terms of section 2 (b) of the Notice, investor funds shall **only** be withdrawn from the trust account **in the event of registration of transfer of the property into the syndication vehicle**; or underwriting by an underwriter whose details shall be disclosed; or repayment to an investor in the event of the syndication not proceeding.

[12] The prospectus issued by the promoter uses the words 'The Villa Holdings' or the 'Company' when referring to the public entity, (The Villa Retail Park Holdings Limited), into which investors' funds were paid, and The Villa when it refers to The Villa (Pty) Ltd, (the entity that would eventually own the immovable property after transfer). For ease of reading, The Villa in this determination refers to the public company to distinguish it from The Villa (Pty) Ltd.

[13] The Villa prospectus[4] offered linked units made up of one ordinary par value share and one unsecured floating rate claim, linked together in a unit at R1000 per unit. In order to effect investments, investors were directed to complete the relevant application form and deposit funds into the trust account of attorneys, Weavind and Weavind Inc. The prospectus[5] further conveyed that investor funds would be retained in the attorneys' trust account in terms of section 78 (2A) of the Attorneys Act (Act 53 of 1979), until registration of transfer into the name of the syndication vehicle. In this respect the prospectus complied with Notice 459.

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4 Prospectus 20 – opening date 15 April 2010 – 14 July 201 (applicable to this investment).

5 Paragraph 19.10 The Villa prospectus 20

[14] In violation of the notice however, the same prospectus[6] made provision for the withdrawal of funds from the trust account prior to registration of transfer to fund, *inter alia*, commissions, directors' travelling, office expenses and other expenses[7]. The prospectus further made provision for the advancement of large amounts of money as loans to the developer of the land, Capicol 1 (Pty) Ltd. The relevant paragraphs are quoted below:

14.1 Paragraph 4.3

'*The Company will operate as a holding company and intends utilising the proceeds of the offer to*:

4.3.1 pay part of the Purchase Price being R14 223 527……. in respect of the entire shareholding in The Villa [(Pty) Ltd*] purchased from Sharemax for an amount equal to 17,77%..... of the Purchase Price to be paid by The Villa* ***for the business referred to in 4.3.2.1 below;*** *and*

4.3.2 ***to advance*** *loan funding in the amount of R58 625 000….. to The Villa [*(Pty) Ltd*] for the purposes of -*

4.3.2.1 paying the Purchase Price which is to be paid to purchase the Immovable Property from Capicol 1 (Pty) Ltd (2007/014113/07) for a projected amount of R2 900 000 000 [Two point nine billion rand]…… (excluding VAT) which purchase will be a purchase of an income generating undertaking as a going concern. The expected

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6 Paragraph 4.3.1

7 The application form used to effect this investment notes that upon payment of the amount into the Attorneys' trust account, Sharemax will deduct 10% of the funds to pay marketing costs.

date of transfer is 1 September 2011. The actual Purchase Price will only be calculated and adjusted thirty days after the Occupation Date, once the income stream (rental) has been determined. The income generating business comprising inter alia, the Immovable Property was purchased for an amount equal to an agreed cap rate of 11.60% per annum return on investment as at date of transfer of the Immovable Property in the name of The Villa [(Pty) Ltd]. *It has further been agreed that in the event of the actual income generated by the business as at the said date being more or less than as anticipated, the Purchase Price would be adjusted to equate the agreed cape rate of 11.60%.....*

4.3.3 Creating a cashflow shortfall fund for the Company in the amount of R2 151 473…..' [Own emphasis].

14.2 Paragraph 4.8.1 reminds investors that '*All monies received from investors of the Company will be deposited in a trust account with the Attorneys who shall control the withdrawal of funds from that trust account.*'

14.3 Paragraph 4.17 states: '*The immovable property has been purchased* ***subject to the suspensive conditions*** *that by no later than 60 days from date of signature the members of the Seller have passed all resolutions as may be required to approve* ***and implement the sale transaction as***

envisaged in the Sale of Business Agreement, *including such special resolution as may be required in terms of section 228 of the Companies Act, and such special resolution shall have been registered with the Companies and Intellectual Property Registration Office*' [own emphasis].

14.4 Paragraph 5.9 of the prospectus details the expenditure to be paid from the amount of R14 223 527. The expenditure comprises amongst others advertising, marketing, office expenditure, travelling and accommodation.

[15] The Sale of Business Agreement (SBA) was not attached to the prospectus but was, according to the prospectus, made available at the promoter's business premises. The SBA reveals what could reasonably be interpreted to be a pyramid scheme (which shall be further discussed later in this determination).

E. THE COMPLAINT

[16] According to the information available to this Office, second respondent was a financial advisor to the late Mrs JM Fivaz (Mrs Fivaz), complainant's mother. During January 2010, second respondent assisted the late Mrs Fivaz with drafting her will. In terms of the will, second respondent together with complainant were nominated as co-executors of Mrs Fivaz's estate. Following the death of Mrs Fivaz in February 2010, second respondent and complainant were subsequently appointed by the Master of the High Court as executors. Second respondent was also appointed as co-trustee in a testamentary trust that was meant to benefit Rusaan Fivaz, complainant's sister.

[17] Soon after the passing of Mrs Fivaz, complainant received her inheritance from her mother's estate. During or about April 2010, respondent advised complainant to invest a sum of R500 000 of her inheritance into The Villa.

[18] It is perhaps necessary to mention that complainant from the onset was sceptical about respondent's proposal of Sharemax, as she had concerns about losing her inheritance. Complainant alleges that she had enquired from respondent about the possibility of investing her funds with RMB. The enquiry however, does not appear to have been pursued to any greater lengths by respondent as his records do not make reference to any other product other than Sharemax. In persuading complainant, respondent allegedly advised that the Sharemax investment was the best available option and assured complainant that the investment was "99.9%" safe.

[19] It has not been disputed by respondent that complainant had specifically asked the question: what would happen if the development ran into financial trouble? In response to the question, respondent allegedly advised complainant that it would never happen, since a portion of The Villa already had prospective tenants. There is no dispute that at the time of advising complainant, The Villa was still under construction.

[20] A further allegation made by complainant is that respondent rushed her into making a decision about the Sharemax investment in order to secure the interest rate of 12.5%. The rate, according to respondent, was on offer for a very limited period and in order not to miss out on the opportunity, complainant had to make the transaction at that time. Complainant subsequently signed the agreement

during April 2010 and effected the payment of R500 000 into Weavind and Weavind's trust account.

[21] The purpose of the investment was to generate income and capital growth. Complainant received two months of income payments, where after the income payments came to an abrupt end. Complainant stresses that the amount paid to her was less than what had initially been promised. She also claims she was unsuccessful in having the income payments restored. Complainant subsequently concluded that she has lost her investment and lodged the present complaint against respondent.

F. RELIEF SOUGHT

[22] Complainant seeks repayment of the amount of R500 000 from respondent.

[23] The basis of complainant's claim against respondent is the latter's failure to render financial services in line with the FAIS Act and the General Code of Conduct, which includes respondent's failure to appropriately advise complainant and disclose the risk involved in the Sharemax investment.

G. THE RESPONSE

[24] In compliance with Rule 6(b) of the Rules on Proceedings of the Office of the Ombud (rules), the Office referred the complaint to respondent on 8 June 2011, advising respondent to resolve the complaint with his client. Respondent's response was received on 24 February 2012 and is summarised here below:

24.1 Respondent confirmed that complainant was his client during the time of the facilitation of her investment into Sharemax.

24.2 He confirms that an amount of R500 000 (of complainant's inheritance) was placed in 'The Villa 20[8].

24.3 Complainant was informed about the related risks, including the fact that the investment was long term. To this effect, complainant apparently had access to Moonstone's weekly synopsis market and investments performance, which according to respondent's allegation did not satisfy complainant. This statement apart from being vague is not borne out by the facts. Respondent's own records show no evidence that complainant was ever advised of the risk involved in Sharemax.

24.4 During September 2010, the South African Reserve Bank (SARB) issued a directive that Sharemax had contravened the Banks Act. It was only at this time that respondent became aware that there was a problem, and not in 2009 as alleged by complainant.

24.5 Respondent became the chairperson of the movement that was established to safeguard the Sharemax investors and FSPs to prevent liquidation.

24.6 Respondent stated that complainant was always aware of the information contained in the application forms for the investment, including the replacement forms[9]. To further bolster his version, respondent referred to complainant's signatures on these documents.

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8 This refers to the prospectus number that was applicable at the time.

9 Complainant initially completed forms to invest in The Villa, prospectus 19. After completion, respondent informed complainant that the offer was fully prescribed. Complainant had to complete new forms for The Villa, prospectus 20.

24.7 Respondent further noted that save for the SARB intervention, it would have been quite possible for Sharemax to have completed the development.

24.8 Respondent confirms having informed complainant that Sharemax was the best option, in line with complainant's requirements. Respondent had full confidence in the product, hence his recommendation to complainant.

24.9 Respondent states that he conducted his due diligence by researching statutory resources and established that Sharemax was regarded as fit and proper by the FSB. Respondent further verified that the prospectus had been registered and approved by the Company Intellectual Property Registration Office, (CIPRO) and accordingly concluded that the product was reliable.

24.10 In summation, respondent submitted that he could not be held responsible for an investment that went wrong.

[25] On 10 June 2015, the FAIS Ombud addressed correspondence to respondent in terms of Section 27 (4) of the FAIS Act informing respondent that the complaint had not been resolved and that the Office had intentions to investigate the matter. Respondent was invited to provide the Office with information on his case with supporting documents in order for the Office to begin its investigation. The letter reads, (omitting for now words not material to the essence):

25.1 '*The prospectus of both the Villa Retail Park Holdings as well as Zambezi Retail Park Holdings declare that the respective entities have never traded prior to the registration of the prospectus, have not made any profit*

whatsoever and are still under construction. In the circumstances, how did you expect the income to be paid, other than out of investors' money?

25.2 *The prospectuses refer to the investment as being an unsecured subordinated interest rate acknowledgement of debt linked to a share; which share was in an entity still under construction. Additionally, the registrar of companies within the prospectus states "that the shares on offer are unlisted and should be considered as a risk capital investment." Given the preceding paragraph please advise as to why you considered the investment to be anything less than an extremely risky venture, without any substance to its guarantee on interest payments?*

25.3 *Was your client properly apprised of these risks? Please provide evidence to this effect.*

25.4 *What information did you rely on to conclude that this investment is appropriate to your client's risk profile and financial needs? In this regard your attention is drawn to the provisions of section 8 and 9 of the General Code.*'

[26] No response was received, nor did respondent submit any supporting documentation.

[27] On 18 February 2017 respondent was invited to address this Office on what appeared to have been a conflict of interest based on the dual role he occupied as executor and designated provider of financial services to complainant and her younger sister, as provided for in the will. The letter read:

1. *Did you at any stage during the preparation of the will inform Mrs Fivaz that an appointment as co-executor and designated financial advisor would place you in an invidious positon of conflict of interest? In the event, we require proof of your communication to this effect.*

2. *Upon your appointment as co-executor by the Master of the High Court, did you at any stage draw the Master's attention to the conflict of interest?*

3. *Did you claim a fee for your services as co-executor? Be advised that your response will be verified with the Master of the High Court. What was the exact fee you claimed as co-executor?*

4. *Upon rendering financial services to complainant barely two months after her mother's death, did you bring to her attention and notice the conflict of interest position you were in? We require proof of this and the steps you took to manage the conflict in line with your office policy on conflict of interest as required by the FAIS Act. We would appreciate a copy of the policy.*

5. *Was the conflict pointed out to your compliance officer? We require proof of same.*

6. *Were you paid commission for the Sharemax transaction? How much commission were you paid?*'

[28] Respondent failed to respond to the letter. Both letters raised important questions which could either clear him from any unprofessional conduct, or

confirm such conduct. His failure to respond can only result in me drawing an adverse inference.

H. DETERMINATION

[29] The following issues arise for determination:

29.1 Whether respondent, in rendering financial services to complainant, violated the Code and the FAIS Act in any way. The pivotal question is whether complainant was appropriately advised, as demanded by the Code.

29.2 In the event it is found that respondent breached the Code and the FAIS Act, whether such breach caused the loss complained of.

29.3 Amount of the damage or financial prejudice; and

29.4 Conflict of interest.

Whether complainant had been appropriately advised

[30] It is respondent's version that the Sharemax investment was the best possible option for complainant at the time and that it was safe. This despite the fact that there is no evidence that respondent presented any other options to complainant. The assertion is made without backing by way of complainant's personal circumstances, the nature and extent of risk involved in the Sharemax product, and how the risk matched complainant's circumstances.

[31] Respondent also claims to have conducted due diligence by researching statutory resources out of which he noted that Sharemax had been approved by the FSB as a fit and proper person and its prospectus had been registered by

CIPC[10]. I note for the record that the approval of Sharemax as a fit and proper person to hold a licence does not mean that the product was safe and compatible with complainant's circumstances. The FSB in any event does not approve products; it authorises the provision of classes of financial services and products[11]. The registration of the prospectus with CIPC likewise means nothing in so far as risk carried by the product is concerned.

[32] Needless to say, none of the two points previously mentioned would have informed respondent about the risk involved in Sharemax. I set out below a few aspects of The Villa prospectus to highlight the magnitude of risk involved in the product:

How Sharemax paid the returns (This is inextricably linked to the violations of Notice 459)

[33] An important question to be answered by respondent is how he satisfied himself at the time of advising complainant that Sharemax was capable of paying the touted returns of 12.5%. The issue is one of viability, given the high returns, which at the time were out of kilter with the rest of the industry. The Villa admittedly had no trading history.

[34] Respondent failed to explain how Sharemax paid the returns to the investors. For the record, Sharemax paid 6% commission (on the full capital invested) to the brokers within two weeks of payment of the funds by investors into the attorney's trust account. (See in this regard Sharemax application forms).

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[10] Formerly known as CIPRO (Companies and Intellectual Property Registration Office), now the Companies and Intellectual Property Commission

[11] ACS Financial Management CC v P S Coetzee, Case No. FAB 1/2016, September 2016, paragraph 35.

Sharemax also took funds to cover office expenses, travelling, legal fees and fees for due diligence. (Refer to paragraph 5.9 of the prospectus). Yet Sharemax paid investors interest ranging between 11.5 % and 12.5%. If respondent did not understand the basic mathematics of this investment, then how did he conclude that the investment was sound and what possible explanation did he give to complainant?

[35] A further explanation of how Sharemax paid the return can be found in the prospectus[12], with reference to the Sale of Business Agreement (SBA) between The Villa and Capicol, which I discuss immediately here below.

Sale of business agreement

[36] The prospectus refers to a Sale of Business Agreement (SBA) concluded between The Villa (Pty) Ltd and the developer, Capicol. Two types of payments are dealt with in the agreement; payments to the developer, and to an agent, Brandberg Konsultante (Pty) Ltd (Brandberg). Respondent made no reference to reading the prospectus, nor did he read the SBA for the purposes of advising complainant.

Payments to Capicol

[37] According to the agreement, investors' funds were moved from The Villa to The Villa (Pty) Ltd, and advanced to the developer of the land. The payments were made before transfer of the immovable property and therefore, were in violation of the Notice. At the time of releasing the prospectus of The Villa, Sharemax published that an amount in excess of R1.2 billion had already been advanced

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[12] Paragraph 4 of prospectus 20

to the developer, in line with this agreement. A brief analysis of the business agreement reveals:

37.1 a mortgage bond[13] would purportedly be registered as security, however, it would be inadequate;

37.2 bearing in mind that the prospectus states that the asset was acquired as a going concern, investors were deceived as the building was still at its early stages of development;

37.3 at the time the funds were advanced to the developer, the immovable property was still registered in the name of the developer;

37.4 the developer paid interest of 14% from which Sharemax took 2 % and paid the remaining 12% to the investors of the Villa;

37.5 there is no evidence that the developer had independent funds from which it was paying interest. Besides, if the developer had the financial standing and worthiness to borrow such large sums of money, at 14 % per annum, it would have gone to mainstream commercial sources;

37.6 the agreement is void of detail relating to the assessment of the developer's credit worthiness;

37.7 no detail is provided to demonstrate that the directors of the Villa had any concern for violating Notice 459;

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[13] Paragraph 4.19

37.8 the conclusion is inescapable that the interest paid to investors was from their own capital.

Payments to Brandberg

[38] An entity known as Brandberg also received advance commission, calculated at 3% of the purchase price of R2 900 000 000. No reasons are provided in the agreement for advancing the commission.

[39] The entity was supposedly the effective cause of the sale, but no valid business case is made as to why commission had to be advanced in the light of the risk to investors.

[40] A cursory reading of the SBA reveals a pyramid scheme.

[41] The prospectus of The Villa was patently in breach of Notice 459 and was littered with conflicting and totally irreconcilable statements to obscure the truth from prospective investors. See in this regard paragraph 19.10 of the prospectus and the reference to investor funds, which were meant to be retained in an attorneys' trust account in terms of section 78 (2A) of the Attorneys Act, until registration of transfer. The paragraph is irreconcilable with paragraph 4.8.1 of the prospectus. There is therefore, no satisfactory explanation of how Sharemax paid income to investors. The only reasonable and valid conclusion from the analysis of the prospectus is that investors were paid income from their own money. The investment was not only high risk, it made no business sense and the disclosures contained in the prospectus were nothing short of misleading. The recklessness was fueled by the lack of proper governance arrangements

and lack of oversight. (See below discussion relating to the poor governance signals contained in The Villa prospectus)

[42] On a balance of probabilities, had respondent explained to complainant the true implications of the SBA, the violation of Notice 459 and the implications for her investment, complainant would not have invested her funds into Sharemax, which leads me to the conclusion that complainant was denied the opportunity to make an informed decision about the Sharemax investment.

Sound Corporate Governance red flags

[43] The red flags cited in this discussion were apparent from reading the prospectus. These red flags have not only debunked the claims of viability, superior performance and safety of the product from the likes of respondent, but demonstrated that the way the investment was promoted was a lie. Respondent, wittingly or unwittingly, sold the lies to his client. I set out below the red flags and expand where appropriate:

43.1 The investment certificates and confirmation papers sent by Sharemax to complainant informed complainant that investor funds would be kept safe in the attorneys' trust account as required by notice 459 of Government Gazette 28690. In the prospectus and several other supporting documents, Sharemax directors informed complainant that investor funds will be loaned to Capicol, pursuant to the terms of the SBA. In simple terms, the directors misled the investors about the true state of affairs.

43.2 Sharemax was the promoter of the property syndication, the company secretary, property manager and administrator and manager of investor

funds. In addition, the directors of The Villa were the same as those of Sharemax, and the Villa (Pty) Ltd. An interesting point to note in respondent's response, is his failure to recognize the obvious conflict of interest that the directors would be faced with as they went about their daily duties. Respondent, for example, had no clue of the costs claimed by Sharemax for rendering the services mentioned in this paragraph. This aspect of the investment alone posed high risk to investors. A basic knowledge of corporate governance[14] would have alerted respondent to the inherent risks in this regard. This alone was sufficient for respondent to question the safeguards for investors and halt the transaction until he had obtained satisfactory answers.

43.3 There is no evidence (and this was patently clear from the prospectus) that an independent board of directors ever existed in the entire group of Sharemax entities at the time, nor were there independent audit, risk and remuneration committees. With no evidence of independent oversight, it is fair to conclude that investors would have no protection whatsoever and were at the mercy of executive directors who were, for all intents and purposes, accountable only to themselves. The executive directors were therefore at liberty to spend investors' monies and pay themselves as they pleased, for they were only accountable to themselves.

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[14] Reference is drawn to the King II report where one of the seven characteristics of good corporate governance is independence. It is explained as: *"Independence is the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareowner. These mechanisms range from the composition of the board, to appointments to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences".*

43.4 Flowing from the lack of oversight arrangements by means of an independent board of directors, respondent did not know whether there were any internal controls, and the extent to which such controls would support reliance on financial statements produced by the entities within the Sharemax stable. It is evident from respondent's version that he had not seen a set of audited financial statements of any of the entities within the Sharemax stable. Respondent for example, could not know whether the assets of the entities within Sharemax were properly recorded, and expenses accurately accounted for, so as not to inflate profits or understate losses.

43.5 There is no evidence that the investors were represented in any of the decision-making structures within the Sharemax group. Unashamedly, respondent made reckless statements to this Office that the development would have been completed were it not for the SARB intervention. Respondent however, forgot to mention he had never seen a set of audited financial statements regarding any of the entities involved in the group.

43.6 Each share sold comprised an unsecured floating rate claim. The prospectus states that the interest payable on the claim component of the unit, **will be determined from time to time by the directors**[15]. There is no evidence that respondent explained to complainant that the so called high interest rate of 12.5% could be zero percent, at the discretion of the

[15] See paragraph 9.3

directors. Despite this, respondent still maintains that the investment was not high risk and was suitable for complainant. This assumption has no merit.

43.7 Paragraph 4.2 of the prospectus notes that the company had never traded prior to its registration and has not made any profit whatsoever. The question that should have immediately arisen in respondent's mind is the source of the income from which investors will be paid.

43.8 From the projected financials in the prospectus[16], it was evident that there would be significant shortfalls. Respondent does not explain how the entity intended to make up these shortfalls, and why, notwithstanding all the information set out in this and the preceding paragraphs, he went ahead with promoting the investment.

About complainant's circumstances

[44] At the time of making the investment complainant was 25 years of age and employed as a manager in an events company. She had limited exposure to investments. Apart from a life policy, complainant had some money in a money market fund with Absa that had been established by complainant's parents while she was still a student. Complainant also co-owned a townhouse with her husband.

[45] Bearing in mind that respondent had carried out no work to understand how much risk complainant's circumstances could absorb, there is simply no basis

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[16] Paragraph 5.12 of the prospectus

on which respondent could have concluded that the Sharemax investment was suitable for complainant. The advice therefore was in violation of sections 8 (1) (a) to (c) of the General Code of Conduct for Authorised Financial Services Providers and Representatives, (the Code). Respondent ignored complainant's enquiries about a possible investment with RMB and simply corralled complainant into investing with Sharemax.

[46] In his defence, respondent attempted to paint the false picture that complainant had knowingly purchased the Sharemax product. He claimed he had explained the risks. The statements are not supported by the undisputed facts. The fact that complainant signed the application forms, are by no means an indication that complainant was fully aware of the risk involved in the investment, or that all the relevant information was disclosed and explained to her. If complainant knew anything about investments, she would have steered clear of this product. She agreed to make the investment because of respondent's recommendations.

Conflict of interest

[47] In her complaint, complainant accuses respondent of taking advantage of her by pressuring her into concluding the Sharemax transaction. The timeline in this case is on its own quite telling. Respondent assisted complainant's mother in drafting her will sometime in January 2010. Complainant's mother passed on in February 2010 due to illness. It is alleged by complainant, and respondent has not denied that soon thereafter, he started distributing the assets of the estate, (presumably after fulfilling the statutory requirements associated with winding up an estate). Not long thereafter, respondent began pressuring complainant into concluding the Sharemax investment, which was signed on 19 April 2010.

[48] For his part, respondent did not particularly respond to the allegations of pressure. He merely provided the excuse that upon being informed that prospectus 19 was fully subscribed, complainant, on her own volition, visited respondent's office to complete application forms for The Villa 20. Respondent fails to recognise that complainant was still acting on his advice. Even at this stage, respondent does not say he had retracted the advice at any stage prior to the conclusion of the investment.

[49] In advising complainant, respondent was fulfilling yet another of his roles in terms of the will: that of a designated financial service provider to complainant and her younger sister. This is where respondent's difficulties arose. Respondent should have realised at the time of preparing the will that he could not wear two hats and inform complainant's mother of the inherent difficulties that would come with his appointment into the two positions. Clearly, respondent saw and still sees no problem with having occupied the two roles.

[50] As an independent provider of financial services, respondent stood in the position of an agent to complainant, who was his principal. From that relationship, certain legal duties arose. The implied duties arise *ex lege*. See in this regard *CF Hodgkinson v Simms* [1994] 3 SCR 377 (SCC)[17]: '. . . *the existence of a contract does not necessarily preclude the existence of fiduciary duties between the parties. On the contrary, the legal incidents of many contractual agreements are such as to give rise to a fiduciary duty. The paradigm example of this class of contract is the agency agreement, in which the allocation*

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[17] *Phillips v Fieldstone Africa (Pty) Ltd* Case No 516/02 SCA, November 2003, para 27

of rights and responsibilities in the contract itself gives rise to fiduciary expectations.

There is no magic in the term 'fiduciary duty'. The existence of such a duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that relationship (CF Bellairs v Hodnett and Another 1978 (1) SA 1109 (A) at 1130F). While agency is not a necessary element of the existence of a fiduciary relationship (Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 16168 at 180), that agency exists will almost always provide an indication of such a relationship.'

[51] In terms of the provisions of the Act and the Code, respondent owed certain statutory duties to complainant. One of those duties is eloquently described in section 2 of the Code that '*a provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry*.'

[52] As executor of the estate, respondent had access to information which is not of a public nature and had to use that information to fully discharge on his duties toward the estate and the heirs. Indeed, it would be unprofessional and a breach of his fiduciary duties towards any of the heirs and the estate for that matter, if respondent were to use the information he accessed during the course of his execution of his duties, to identify opportunities for himself. This is exactly what happened in this case if one looks at the time line I have described in paragraph [44].

[53] The principles which govern the actions of a person who occupies a position of trust towards another were adopted in South Africa from the equitable remedy of English law: '*The fullest exposition in our law remains that of Innes CJ in Robinson v Randfontein Estates Gold Mining Co Ltd, supra, at 177-180. It is, no doubt, a tribute to its adequacy and a reflection of the importance of the principles which it sets out that it has stood unchallenged for 80 years and undergone so little refinement.*

'*Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his interests conflict with his duty. The principle underlies an extensive field of legal relationship. A guardian to his ward, a solicitor to his client, an agent to his principal afford examples of persons occupying such a position. As was pointed out in The Aberdeen Railway Company v Blaikie Bros. (1 Macqueen 474), the doctrine is to be found in the civil law (Digest 18.1.34.7), and must of necessity form part of every civilized system of jurisprudence. It prevents an agent from properly entering into any transaction which would cause his interests and his duty to clash. If employed to buy, he cannot sell his own property; if employed to sell, he cannot buy his own property; nor can he make any profit from his agency save the agreed remuneration; all such profit belongs not to him, but to his principal. There is only one way by which such transactions can be validated, and that is by the free consent of the principal following upon a full disclosure by the agent . . . Whether a fiduciary relationship is established will depend upon the circumstances of each case . . . But, so far as I am aware, it is nowhere laid down that in these transactions there can be no fiduciary relationship to let in*

the remedy without agency. And it seems hardly possible on principle to confine the relationship to agency cases[18]*'.*

[54] So oblivious was respondent to the conflict of interest that was brought about by his occupying the two positions, that he did not even claim to have drawn complainant's attention and notice to the conflict of interest. In advising complainant, respondent was obliged to act in complainant's interest and recommend an investment suitable to her circumstances. He failed to do so and simply rushed to recommend the product, which brought him the highest commission with no claw back. Respondent had every incentive to ignore any other product that would suit complainant for the commission paid by Sharemax was lucrative in terms of industry standards. It has not escaped me that the very idea of being nominated as executor or co-executor of one's client's estate, as a financial advisor, is sufficient to conclude possible undue influence on the part of the provider.

[55] Respondent could not have acted fairly towards complainant. He had far too many interests to mind and was likely to put his interests before those of his client. For example, other than blaming the SARB, respondent cannot justify why he put such a substantial part of complainant's inheritance into the high risk Sharemax investment in circumstances where he had hardly carried out any due diligence work - if at all he was capable of conducting due diligence. He does not explain how the circumstances and needs of complainant could only be matched by the Sharemax product. Respondent violated his duty to act in the interests of complainant and the financial services industry.

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18 Phillips v Fieldstone supra, paragraph 30

Causation

[56] The principles of causation were explained in *Standard Chartered Bank of Canada v Nedperm Bank Ltd* 1994 (4) SA 747 (AD); [1994] 2 All SA 524 (A). Causation has two legs, namely, factual and legal.

[57] In advising complainant, respondent presented no other options but the Sharemax product. He has not hidden his enthusiasm for the Sharemax product even at the time of responding to this Office and, in his own way, tried to justify why he recommended the product. He failed to deal with the risks involved in Sharemax when advising complainant. It thus cannot be denied that had respondent firstly appreciated the risk and secondly, explained it to complainant, the latter, in all probability, would not have invested in Sharemax. The first leg of the causation enquiry, the "but for" test is thus satisfied. But for respondent's inappropriate advice, there would be no investment in Sharemax and consequently no loss.

[58] That, as Corbett CJ[19] said, does not conclude the enquiry. It is still necessary to determine legal causation, i.e. whether the furnishing of the poor advice was linked sufficiently closely or directly to the loss for legal liability to ensue, or whether the loss is too remote. The test:

"*is a flexible one in which factors such as reasonable foreseeability, directness, the absence or presence of a legal policy, reasonability, fairness and justice all play their part*[20]".

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19 ACS Financial Management CC v P S Coetzee, Case No. FAB 1/2016, September 2016, paragraphs 61-63

20 See footnote 19 *supra*

[59] The learned judge added that:

"*the reasonable foreseeability test does not require that the precise nature or the exact extent of the loss suffered or the precise manner of the harm occurring should have been reasonably foreseeable for liability to result. It is sufficient if the general nature of the harm suffered by the plaintiff and the general manner of the harm occurring was reasonably foreseeable.*

The main factor limiting liability is the absence of reasonable foreseeability of harm. This is an objective question[21]."

[60] I refer to some, but not all, the glaring indications. The violations of Notice 459 as communicated by the directors in the prospectus, followed by the conflicting statements contained in the prospectus, (highlighted in this determination in paragraphs 8-15); the SBA, which simply explained no ordinary business proposal but something which, in effect, amounted to a pyramid scheme; and the obvious poor governance practices conveyed in the prospectus, none of which appear to have caught respondent's eye. The ineluctable conclusion is that the collapse of the scheme was not only reasonably foreseeable but, in all probability, inevitable. The precise nature of the collapse and the intricate details are not necessary.

[61] The SARB's intervention as respondent earlier mentioned, interrupted the development. The less said of respondent's statement, the better. SARB was discharging its duties in intervening in Sharemax besides, there is no evidence that SARB ever took control of the business of Sharemax at any stage[22].

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21 ACS Financial Management supra,

22 See in this regard Judgement delivered on 7 October 2014: Willem Van Zyl & Deon Pienaar v PricewaterhouseCoopers & Others HC WC Case No.: 12511/2013.

[62] The loss was inevitable.

I. FINDINGS

[63] I make the following findings:

63.1 Respondent, in complete disregard for complainant's interest rendered inappropriate and negligent advice.

63.2 Respondent rendered financial services to complainant while faced with a conflict of interest and failed to disclose the conflict of interest to complainant.

63.3 Respondent treated complainant unfairly.

63.4 Respondent failed to disclose the risk involved in the investment, in violation of Section 7(1).

63.5 Respondent denied complainant the opportunity to make an informed decision about the Sharemax investment.

63.6 Respondent, in violation of section 2 of the Code, had carried out no due diligence. This saw him advising his client on an investment product he hardly knew anything about.

63.7 Respondent's advice caused the loss.

J. QUANTUM

[64] Complainant invested an amount of R500 000.

[65] Accordingly, an order will be made that respondent pay to complainant an amount of R500 000 plus interest.

K. THE ORDER

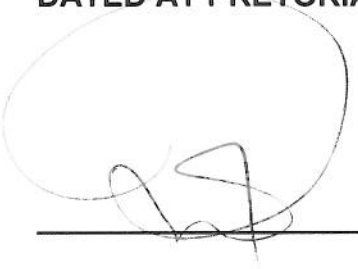
[66] In the result, I make the following order:

1. The complaint is upheld.

2. Respondents are ordered to pay complainant, jointly and severally, the one paying the other to be absolved, the amount of R500 000 to complainant.

3. Interest on this amount at the rate of 10.25% per annum from the date of determination to date of final payment.

DATED AT PRETORIA THIS THE 10th DAY OF APRIL 2017.



NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS