IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 05701-12/13 LP 1

In the matter between

MSJP BOSMAN **Complainant**

and

LA MACHRI FINANCIAL SERVICES CC **First Respondent**

HERMINA CHRISTINA LANGDON **Second Respondent**

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

A. INTRODUCTION

[1] Complainant made two investments in Sharemax property syndications. The investments were made with the assistance and advice of the respondents. After making the investments, interest payments stopped and complainant learned that Sharemax was in trouble. Since interest payments ceased, complainant received no further payments and his capital is also lost. He made a complaint to this office.

B. THE PARTIES

[2] Complainant is Marthinus Stephanus Johannes Petrus Bosman, who at the time of making the first investment was 72 years old. He resides on a farm in the Swartwater District, Tom Burke.

[3] The first respondent is La Machri Services cc, a close corporation having its principal place of business at 74 Kleinhans Street, Bethal. First respondent was a licensed financial services provider (FSP) with registration number FSP 33432. This license, as at 11 June 2013, had lapsed.

[4] The second respondent is Hermina Christina Langdon, a key individual of the first respondent who has the same address as the latter.

For purposes of this determination I will refer to both respondents as the respondent.

C. THE COMPLAINT

[5] Complainant wanted to make an investment in order to generate a monthly income. Respondent advised him to invest in Sharemax. He states that at the time of making the investment his risk profile was determined as “moderate” and his financial situation was described as “Good”. However, complainant points out that the investments he made represented all the money he had. He describes his current financial situation as “dire”.

[6] Subsequent to making the investments, the interest payments began and continued till about July 2010 when all payments abruptly ended. He tried to contact respondent but got no response. Nor did he receive any communication from Hermina Langdon. He learnt about the problems at Sharemax from the Media, the internet and from calling the Sharemax office.

[7] With the assistance of respondent, complainant first invested R120 000 – 00 in Sharemax Zambezi Retail Park Holdings Ltd (Zambezi) on the 14 February 2008. The second investment of R200 000 – 00 was made in Sharemax The Villa Retail Park Holdings Ltd (The Villa) on the 17 February 2009.

[8] Complainant wants his capital to be repaid.

D. THE RESPONSE

[9] The complaint was forwarded to respondent and a response accompanied by the client advise record was received.

[10] According to respondent it is not disputed that she assisted complainant in making both investments. The circumstances are as follows:

a) Complainant had already invested in Sharemax through another FSP. A consultant of Sharemax referred complainant to respondent. Respondent is based in Bethal and complainant lives in Tom Burke which is a long distance away. As a result, the parties did not meet and communicated on the telephone.

b) Complainant had invested in a Sharemax product, Atterbury Décor, which had been successfully sold and complainant received a payment of R137 000 – 00 from the investment. Complainant wanted to reinvest the funds;

c) Complainant already knew about Zambezi and requested an investment in it. He wanted to invest R120 000 and wished to retain R17 000 as liquid funds. Respondent posted all the necessary documents to complainant, including the prospectus;

d) Complainant posted the completed forms back to respondent and R120 000 was deposited into Weavind and Weavind's trust account. The first investment was made on the 14 February 2008;

e) Thereafter complainant contacted respondent and requested a further investment in Sharemax, this time he wanted to invest in The Villa. According to respondent, complainant knew about the investment and wanted to invest an amount of R200 000.

f) Again, the same process was followed where respondent posted the documents to complainant, including a prospectus. The signed documents were returned, duly signed by complainant and an investment of R200 000 was made on the 17 February 2009.

g) Respondent disputes that the investments were made on her recommendation, complainant already had positive experience of Sharemax and wanted to invest further.

h) Respondent explains that she was licensed and made the first investment as a representative of USSA and was licensed in her own right in respect of the second investment.

i) Respondent then provides an explanation of the investment and states that where a client wants an income plus capital growth then property syndication is an appropriate investment strategy. Respondent also sets out some of the risks associated with property syndication. However, none of these risks pertain to the Zambezi and The Villa models. Respondent does not point out that in the case of these investments, no building existed and in fact, when investments were made, Sharemax did not own any property at all.

j) Respondent then explains the benefits of property syndication, in particular that investors may participate in property investments without having to mobilise large amounts of capital.

k) Respondent quotes from a book, “The Fundamentals of FAIS Compliance” and refers to the registrar’s requirements for proper disclosure by promoters. Significantly, the

book also refers to Notice 459 which is intended to offer investors protection. I will deal with this in more detail below.

l) Thereafter respondent lists the various external companies which verified the information in the prospectus. The purpose of this was to demonstrate that Sharemax was FAIS compliant.

m) Respondent concludes by stating that the management of Sharemax is now in the hands of Frontier Asset Management. She attaches some of the correspondence from the latter.

[11] This office wrote a letter to respondent with two purposes in mind:

a) That respondent, in terms of rule 6 (b), had six weeks to attempt to resolve the complaint with complainant; and

b) In the event that the matter was not resolved, then certain information was requested pertaining to respondent's conduct in assisting complainant in making the investment.

[12] The parties were not able to resolve the matter and respondent provided answers to only some of the queries made by this office. I deal with this below as this is significant:

a) A comprehensive statement was requested detailing what was discussed with complainant regarding the nature of the investment, the inherent risks associated with the investment and the reason why the investment was deemed to be appropriate to the needs of the complainant. This question was not answered by respondent.

b) Respondent was required to produce documentary evidence demonstrating the full terms and conditions as well as the explanation of the risks in the investment so that complainant could make an informed decision. Respondent produced some documentation, which I deal with below, but points out that complainant was already aware of the product and the investment were made at his request and was not

recommended by respondent. Respondent provided no evidence that the risks in this investment was brought to complainant's attention.

c) Respondent was asked to explain why, bearing in mind complainant's age, financial circumstances and tolerance for risk this investment was found to be an appropriate alternative. To this respondent points out that complainant was deemed to be of moderate risk and that he chose to invest in this product.

d) Documentary evidence was requested to demonstrate that the required due diligence was conducted by respondent to satisfy herself that the investment was suitable for complainant. This question was not answered directly and there is no evidence that respondent conducted any basic due diligence regarding the nature of this investment and the inherent risks. The nature of the investment is disclosed in the prospectus. Respondent does not state that she read and understood the prospectus but relies on the fact that complainant read and understood it. I deal with this in more detail below.

e) Finally, respondent was asked to give details of disclosure of her commission to complainant. Here respondent relies on documents generated by Sharemax. The documents, however are contradictory. First the documents create the impression that investors funds will be deposited and maintained in an attorney's trust account and that commission is paid by the promoter and not from investor funds. Then the documents, including the prospectus, state that after the cooling of period 10% of the funds will be deducted to be used to pay commissions. The document then states that interest will nevertheless be paid on 100% of the investment as "eventually" the commission will be paid by the promoter. There is no evidence that this was disclosed to complainant.

[13] I now turn to the documents provided by respondent as part of her client advice records. At the outset I point out that there are two sets of documents, one for each investment,

however the documents are the same save that one set refers to Zambezi and the other to The Villa. The material documents, as well as my comments are as follows;

a) The first document is titled “Client advice record”. Here respondent notes that complainant received an amount of R137 000 from a Sharemax investment and wanted to invest R120 000 from this amount. It is recorded that client requires an income of R1000 per month and capital growth. The Zambezi investment promised an interest payment of 12% per annum payable monthly. The prospectus makes it clear that this is a risky investment and must be considered as a risk to capital. The client advice indicates that complainant did not want to risk his capital and expected capital growth. There is no evidence that this was drawn to complainant’s attention. Nor does she state in her response to this office that she explained the risks to complainant. Complainant’s financial situation is recorded as “good” how respondent came to this conclusion is not recorded. The document notes complainant’s risk profile as “moderate to aggressive”, a risk assessment was carried out and I deal with it below.

   This document states the motivation to invest in Zambezi as it being the complainant’s preferred provider as he had a history with Sharemax.

b) The next relevant document is the “letter of Introduction” which was delivered to complainant. The purpose is to introduce the respondent and to give information about their services. It is significant that respondent records that she holds a post graduate diploma in financial planning from UOVS, she is a registered CFP (chartered financial services provider). Respondent also states that she is accredited to sell other property syndication products from PIC and Bluezone. Respondent is also a member of the Financial Planning Institute of South Africa as well as Masthead Financial Advisors Association.

   The document states that the respondent is FAIS compliant and, significantly, assures that complainant can expect appropriate financial advice.

c) Respondent provided a copy of a service agreement entered into with complainant wherein the latter appoints respondent as his FSP. The form contains a check list of products required by complainant and the block for unsecured shares is ticked off. There is no evidence that respondent explained this to complainant.

Of significance is a paragraph headed “FSP Duties”, this paragraph sums up respondents’ duties consistent with the Act and The Code. In effect this paragraph undertakes, contractually, that respondents will carry out their mandate in keeping with the Act and The Code.

There is a paragraph wherein a disclosure is made as to commission earned by respondent. There are a number of different options based on product type. For purposes of this investment, the document notes that commission will be paid by the product provider. This is contradicted by the Sharemax terms and conditions which state that 10% will be deducted from investor funds to pay commission. There is no record that this was explained to complainant.

d) The next document worth noting is a standard Sharemax document titled “Compulsory Coverpage (sic) for New Investments”. The purpose is to record the documentation tendered in making a new investment in a Sharemax product. The document records that second respondent is the financial advisor and Rothea, a Sharemax employee, is the consultant.

The importance of this document, for purposes of this determination, is that the document notes that “Relevant, fully completed and signed prospectus” is attached to the application. This serves as confirmation that complainant received and read the prospectus. The difficulty I have with this is that it is highly unlikely that complainant actually read the prospectus and even if he did, he is unlikely to have understood it. If indeed he understood the prospectus, he would have found out that this is a high-risk investment where his capital could be lost and that his funds will be used to make an

unsecured loan to the developer. No 72-year-old will willingly take this risk. Moreover, there is no evidence that respondent checked with complainant if the latter had read and understood the prospectus. Nor is there any record that respondent took complainant through the prospectus and explained the material terms and conditions.

E. THE LEGAL FRAMEWORK

[14] This matter must be determined with reference to the following legal framework:

a) The provisions of the Act, in particular section 16 (1) (a);
b) The provisions of the Code, in particular sections 2, 3, 7 and 8;
c) The common law relating to delictual liability; and
d) The common law relating to the contractual relationship between the parties.

F. THE ISSUES

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

a) Did Respondent, in advising her client, conduct herself 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 her contract with Complainant; and
d) Did Complainant suffer loss and if so, what was the cause of the loss and the quantum thereof.

G. FINDINGS OF FACT

[16] There are no substantial disputes of fact in this matter. The following is material:

a) Respondent admits she acted as complainants FSP in respect of both contracts;

b) Respondent entered into a written agreement with complainant in terms of which she agreed to provide financial and intermediary services to complainant;

c) It was an express term of the agreement that respondent will carry out her obligations in a manner consistent with the Act and The Code;

d) The fact that complainant chose to invest in Sharemax did not relieve respondent of her duties as a licensed FSP;

e) There was no meeting between the parties due to the distance between them. However, on respondent's own version, the parties were able to communicate effectively via telephone;

f) Respondent posted the application forms and the prospectus to complainant who signed and returned them to respondent. The respondent had both the time and opportunity to discuss the contents of the prospectus with complainant so that the latter could make an informed decision; and

g) There is no record that respondent informed complainant that the investment was high risk and that he could lose his capital, nor is there any record that respondent explained the nature of the product with reference to the prospectus; and

h) Crucially, there is no record that respondent explained to complainant that the investments in Zambezi and The Villa were different to all the Sharemax products that came before. Respondent had to explain that his previous investment in a Sharemax property syndication was different to the Zambezi and Villa promotions. Respondent was obliged to explain that neither Zambezi nor The Villa owned any buildings or any property and that these companies had no trading history and no independent means to pay commissions and interest.

[17] On the facts before me, the following can be concluded:

a) Even if one accepts that complainant elected to invest in these Sharemax products, respondent was nevertheless expected to carry out her duties as a licensed FSP acting in the best interests of her client. Respondent cannot expect to earn a generous commission of 6% of the capital simply for posting the forms;

b) Respondent failed to carry out a need's analysis. Respondent avers that this was a single need investment and the parties agreed that there was no need to carry out a needs analysis. But it is undisputed that complainant wanted capital growth and there is no record that he was willing to risk any part of his capital. Nor is it in dispute that these funds represent all the money he had. One has to bear in mind that complainant had retired and was 72 years old and had no prospect of ever replacing any lost capital. Respondent had knowledge of this.

c) Respondent, according to her record of advice, carried out a risk analysis. Respondent in fact sent complainant two questionnaires, one from Sharemax and another of her own. Both documents took the form of tick boxes which complainant had to select in order to answer the question. The Sharemax document had absolutely nothing to do with risk assessment and merely asked questions about its own product. None of these questions were pertinent to complainant's financial risk profile.

Respondents own questions required complainant to choose from multiple choice answers, with each answer given a preselected score. The scores are then totalled up and the risk profile is determined. Again, these questions are not pertinent to these investments nor are they pertinent to the complainant's actual financial circumstances. This is demonstrated by the fact that respondent found complainant to be a "moderate to aggressive" investor. This is not supported by the facts. Complainant is an aging pensioner who was investing all his savings and had no means to replace lost capital.

How can this be "moderate"? Complainants circumstances tell one that he is nothing other than a conservative investor with no appetite for any risk. I pause to note that on her own version, respondent is highly qualified, being a CFP, and should easily work out her client's risk profile. It does not require a questionnaire that is pre-weighted to produce skewed results not consistent with client's actual financial circumstances. Complainant's financial circumstances and aversion to any risk strongly indicates that the Sharemax product was entirely inappropriate and an alternative should have been offered; at least respondent ought to have told complainant that she does not recommend the Sharemax investment.

d) Respondent, instead of focussing on the best interests of her client, was firmly focused on Sharemax's generous commission, which incidentally was paid in full within two weeks of the client funds being paid and payment is not subject to any clawback.

[18] Respondent was initially under the supervision of USSA but before the second investment was made, obtained a category 1.10 license. This means that she must have been trained by USSA in the product and thereafter took the responsibility in her own right to be familiar with the product. This office is therefore justified in accepting that respondent read and understood the prospectus in respect of Zambezi and The Villa (the terms and conditions of which are near identical). Thus, the following conclusions follow:

a) Respondent would have understood from the prospectus that neither Zambezi nor The Villa had any trading history and had no independent income from which to pay commissions and investor returns. Nor did these entities have any immovable assets. Respondent knew, from the prospectus and the Sharemax application forms that her commission was, at least initially, being paid out of complainant's funds. Respondent failed to disclose this to complainant.

b) Respondent would have noticed that contrary to what was initially stated in the prospectus, it informs that 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). Respondent would have known that this was in breach of Notice 459 and was in fact illegal. This was not disclosed to complainant;

c) Respondent would have found out 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). Again, not disclosed to the complainant;

d) One would expect Respondent to 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 she 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 already deducted by the promoter as administrative fees. The developer then paid the promoter 14% interest on the loan; a further 14% taken out of the 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). This was not explained to complainant;

e) Would have notified complainant that this investment had to be regarded as a risk to capital and that no guarantees are given regarding the performance of the investment (again, stated in the prospectus); and

f) Should have told complainant 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).

Clearly by failing to draw complainant's attention to the above information, complainant failed in her legal duties to her client. Respondent was in breach of contract and had also committed a delict.

H. APPLICATION OF LAW

[19] 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 her client and by her conduct 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. 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. Respondent contravened section 8 (1) (a), (b) and (c) of The Code.

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

[21] Further, this office as well as the Board of Appeal has consistently found that there existed a contract between FSP and client. In this case the parties entered into a written agreement. It was an express term of the contract that Respondent, in carrying out her

obligations, will comply 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.

[22] In a number of recent judgements in the high court, it was found that complainants claim 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 her legal duties towards the client; and
b) whether in terms thereof the respondent acted wrongfully and negligently.

[23] 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 she intended to sell;
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; and
c) As a basic step she was expected to read and understand the prospectus.

[24] Having read the prospectus respondent was reasonably expected to make a disclosure to complainant as stated above. By failing to make a full disclosure of these facts to complainant, respondent failed in her duty to her client.

[25] The respondent also acted wrongfully and negligently, she was under a legal duty to make a disclosure of these facts to complainant and if she did not acquire these facts, e.g. by not reading the prospectus, or knowingly withheld them then she acted in negligent breach of that duty.

[26] The respondent must be judged by the standard of a reasonably competent FSP in the same circumstances. In fact, the respondent must be judged by the standards of a reasonably competent CFP (a higher standard). Then the inquiry must progress to the next question: would a reasonably competent CFP have advised complainant differently. It is overwhelmingly clear that a reasonably competent FSP or CFP would have read and understood the prospectus and would not have advised a 72-year-old man 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."*

I refer to the following decisions:

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

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

[27] Respondent was expected to make an evaluation of the product from the prospectus and give advice based on the client's requirements and tolerance for risk. She failed to do that and was therefore negligent, in this case possibly even dishonest, and she is accordingly liable for damages.

[28] Thus, both factual and legal causation was established.

I. REMEDY AND QUANTUM

[29] Complainant requested that all of his capital plus promised returns be paid to him. Complainant lost, in respect of both investments in Sharemax, his entire capital of R320 000. 00. I intend to make an order that this amount be repaid and will also award interest post service of this order.

J. THE ORDER

[30] Respondent is ordered to make payment to the complainant as follows:

1. The complaint is upheld;
2. Payment of the amount of R320 000 – 00;
3. Interest on the said amount at the rate of 7% per annum from a date 14 days from service of this order to date of payment.
4. The complainants are to cede their rights in respect of any further claims to these investments to the respondent.
5. 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 20TH DAY OF AUGUST 2020.

ADV NONKU TSHOMBE

OMBUD FOR FINANCIAL SERVICES PROVIDERS