IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 06062/12-13/ FS 1

In the matter between

RENETTE ROOS **Complainant**

and

STEPHAN PARKER T/A FSP ADVISORY FINANCIAL SERVICES **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 invested her pension funds in Sharemax The Villa Retail Park Holdings Ltd (The Villa). The investment was made on the advice of respondent. Since September 2010, complainant stopped receiving her monthly income from the investment and has not received anything since. Complainant believes that she has also lost her capital. Complainant filed a complaint with this office for investigation and determination.

[2] Respondent was given notice to attempt to settle the matter within 6 weeks. The parties were unable to settle the matter and the matter proceeded to adjudication.

B. THE PARTIES

[3] Complainant is Renette Roos, who is currently 61 years old and who was 50 years old at the time when the investment was made. She resides in Bethlehem in the Free State.

[4] Respondent is Stephen Parker a financial services provider (FSP) trading as FSP Advisory Financial Services of 1 A P Brink Street, Langenhovenpark, Bloemfontein. Respondent was not licensed to market the Sharemax product. He acted, at all material times, as a representative of USSA. Respondent was registered with the FSCA under the Trading name of Stephen Parker Makelaars, with FSP No 32879; this license has since lapsed.

C. THE COMPLAINT

[5] Complainant received R500 000 (five hundred thousand rand) in respect of her pension. She wanted to invest the funds so that she can receive a monthly income from the investment and she wanted capital preservation. The Sharemax investment was made on the advice of respondent. The whole amount was invested.

[6] In January 2009 respondent visited complainant in Kimberly and assured the latter that this was a guaranteed investment and the interest income was also guaranteed.

[7] When complainant made the investment, respondent still assured complainant that her monthly interest income and her capital was guaranteed. The investment was made on the 6 February 2009 and Sharemax processed the application on the 9 February 2009. Thereafter, share certificates were issued. There were no indications that other or alternative products were offered by respondent.

[8] Complainant's problems began in September 2010 when her interest income stopped. Her fear was that her capital was possibly lost as well. Complainant became concerned about her investment when an article appeared in Rapport on the 25 July 2010; that tens of thousands of investors were not receiving funds from Sharemax. On the same date Willie Botha, managing director of Sharemax, sent a circular letter in response to the Rapport article. However, since September 2010 all interest payments stopped and complainant was left with no source of income.

[9] Complainant made several calls to respondent and the Sharemax offices, but received no assistance. Instead, more correspondence was received from Sharemax, but no further payments.

[10] Complainant wants payment of her capital as well as the lost interest.

There can be no dispute that there is no prospect of complainant recovering her capital from Sharemax.

D. THE RESPONSE

[11] A copy of the complaint was referred to respondent who sent his written response to this office. The response is not dated. He explains his version of how the investment was made and answered the questions posed by this office in the letter, in terms of Section 27, which was sent to him.

[12] In dealing with the response, I will state respondent's version, then immediately deal with it in the light of all the other evidence available to this office.

No Blame

[13] Respondent states that since the demise of Sharemax, complainant told him on several occasions that she did not blame him and can see no wrongdoing on his side.

[14] This however does not emerge from her complaint. Complainant clearly suggests that respondent advised her to invest in a product that was not appropriate for her. She insists that she was unable to risk her funds and was therefore looking for an investment that guaranteed her capital and monthly income. It is undisputed that Sharemax collapsed within about 18 months of complainant investing. It is highly improbable that she will find respondent blameless. It is not in dispute that the investment was made on the advice of respondent.

Sharemax Track Record

[15] Respondent was called upon to explain why he recommended Sharemax as a suitable investment for complainant. He provided the following reasons:

a) Respondent states that he first waited for several years following the investments in Sharemax and only after seeing positive results being achieved with their first twenty projects did respondent deem it suitable for his clients who were seeking good income and growth prospects;

b) Respondent found Sharemax's track record of average income in excess of 9% and actual growth of 8% better than most other investments;

c) Sharemax was an FSCA registered product supplier for 10 years and respondent carried out due diligence regarding this product;

d) Respondent visited the Sharemax head office on three occasions and even visited the Zambezi Mall and The Villa;

e) S A Retail, a listed company, bought ten properties from Sharemax investors which respondent found to be proof that Sharemax was a leader in property syndication. He was of the view that Sharemax could be trusted as a sound investment. Even investing his own funds in it.

[16] Respondents reliance on Sharemax's track record is not helpful and exposes respondents lack of basic knowledge into how property syndication works. He failed to realise that all of Sharemax's projects, before Zambezi and The Villa, were different. Previously Sharemax acquired income generating properties and investors received returns from rental income. Investors also received their capital back when the properties were sold at a profit. Zambezi and The Villa were different. Sharemax called for investment, promising capital growth and income, when it did not own any assets, the shopping Malls were still being built and the property still belonged to the developer. Sharemax pointed out that it had no trading history and no independent means to pay investors their monthly interest. Respondent claimed to have visited Zambezi and The Villa, I find it unacceptable that he failed to notice that these malls were incomplete and failed to inform his clients, he also did not tell complainant that Sharemax did not even own the property. The risks were obvious and, as I will show below, the risks were known to respondent. The issue then is, whether or not those very risks were explained to complainant.

How was income paid

[17] Bearing in mind that Sharemax had no independent means with which to pay investors' income, this office requested respondent to explain how he believed Sharemax was going to make these payments other than from investors own funds? Respondent's response, which I summarise below, is significant:

a) Respondent states that the prospectus explained "in full the flow of funds", and refers this office to paragraph 4. Respondent quotes from paragraph 4.9 and 4.13 and explains that investor's funds will be kept in an attorney's trust account and interest accrued will be paid to investors. He explains further that income payment was derived from monthly interest payments on a loan to the developer. Respondent states that he had no reason to question the integrity of how the payments were made.

b) Significantly, respondent refers to the Sale of Business Agreement between the promoter and the developer, Capicol 1 (Pty) Ltd. He explains that in terms of the agreement, the developer or seller will pay to The Villa interest on all amounts raised in each prospectus. Respondent observes that each prospectus was registered with the registrar of companies.

c) As respondent understands the scheme, the developer had “a loan agreement with every single investor”. This he deems to be “standard everyday practice” in developing new commercial buildings, where the investors took the place of a bank.

[18] The difficulty I have with this explanation is that it does not accurately explain what is stated in the prospectus and disclosure documents. Nor do the contracts support respondent’s explanation. The simple issue was whether or not investor funds were being used to pay for administrative costs as well as their own interest payments?

[19] To begin with, the prospectus and disclosure documents state that the attorneys, after the cooling off period has passed, will pay investor funds out of trust to the promoter to use at their discretion in developing the property. There was absolutely no prospect of investors receiving interest accrued in the trust account. Besides, the attorney’s trust investment account did not pay interest at the rate of 12% per annum, which is what investors were promised, and before Sharemax collapsed, they did indeed pay at a rate of between 10% and 14%. If this is what respondent explained to complainant, then he mislead the latter. It is also worth pointing out that the manner in which investor funds were paid out of trust to the developer, before transfer of the property took place, was in contravention of Notice 459. Respondent did not deal with this at all.

[20] Respondent either did not understand the Sale of Business Agreement or conveniently gives it a spin that suits his version that there was no risk in the investment. In effect, the promoter used investor funds to advance a loan to the developer. The loan was unsecured. The developer paid the promoter interest on the loan at a rate of 14%. This agreement also informs that 3% of investor funds were paid in “agents commission” to a company called Brandberg. This office is aware that none of Sharemax’s investors were given a copy of the Sale of Business Agreement. Therefore, respondent was under a duty, both at common law and The Act and The Code, to make a full and frank disclosure of the provisions of this agreement to complainant. Respondent provides no evidence that this was in fact done. On the probabilities, had the complainant been told that her funds were not going to enjoy the protection of a trust account, but will be used by the promoter to make an unsecured loan to the developer of the property, she would not have invested.

[21] Respondent, however, evaded the question posed by this office, viz. did Sharemax pay commissions and investor returns out of their own funds? On respondent’s own version, investors were indeed paid out of their own funds, Sharemax had no other funds available to it. Capicol, the developer, paid interest to Sharemax from the very funds they borrowed. Sharemax, in turn used this interest payment to pay investors their monthly income. Effectively, the investors were being paid out of their own funds. This was certainly not disclosed to complainant by respondent.

[22] Respondent concludes this part of his response by stating that complainant was well aware of the risk of investing in a new property development but was satisfied with how investors were to be paid until the property was fully developed, after which this was going to be “a wonderful investment at very little risk”.

[23] There is no record of advice confirming that respondent explained to complainant how investors were going to be paid and that she understood the risks. This investment was not one with very little risk. Respondent is contradicted by the prospectus and the disclosure document that describe this investment as risk capital investment where the income and capital is not guaranteed. Perhaps the investment would have been "wonderful" after the mall was completed and occupied by tenants. Respondent fails to explain the risks while the building was still in progress and while Sharemax had no independent income.

Directors responsibility/promoters undertaking

[24] Respondent refers to paragraph 25.3 of the prospectus and points out that if the investment was not proceeding, the promoter undertakes to refund the investment to investors.

[25] There is however no comfort to be had from this as this part of the prospectus merely states the law. Where a prospectus was not fully subscribed, within the prescribed time period, the investors must be refunded. But the prospectus as well as the disclosure document states that funds will not be held in trust pending transfer, instead the funds were paid out of trust to the developer who used the money to advance a loan to the developer. Respondent knew this. There was no prospect of any refund from the promoter, the money disappeared within seven days of being paid into trust.

No Loss of Capital

[26] Respondent refers to the Section 311 compromise sanctioned by the high court and expresses the view that investors enjoy protection and their capital is not lost. The Section 311 order came after Sharemax was placed into liquidation. We now know that investors

were not paid as proposed in the compromise. In fact, there is no prospect of investors enjoying any protection and receiving any payments.

Lack of Training

[27] In his defence, respondent points out that he, and other FSPs, did not have training which would have equipped them to better to consider investments such as property syndication. He also adds that it was only in 2011 that the FSB, for the first time, provided some training. He is of the view that this training would have "influenced advice drastically".

[28] This is a startling admission by respondent. He actually admits that he was not competent to market the Sharemax product. We know that he was authorised to sell the product only as a representative of USSA and was not in possession of a license in his own right. As I point out below, if respondent did not believe he was competent to provide financial advice in respect of this product, he should not have marketed it to complainant. See Durr v ABSA Bank.

Disclosure Document

[29] USSA provided respondent with a "disclosure document", which had to be signed by complainant after respondent explained its contents to her. 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.

[30] 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 her 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.

There can be no dispute that respondent, as a licensed FSP, was obliged to comply with The Code and explain the nature of the product and the risk to complainant's capital.

[31] 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.

E. THE LEGAL FRAMEWORK

[32] 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

[33] 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.

G. APPLICATION OF LAW

[34] 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 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.

[35] 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.

[36] Further, this office as well as the Board of Appeal have consistently found that where a client invests in a product pursuant to financial advice given by a 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 , 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.

[37] 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 his legal duties towards the client; and

b) whether in terms thereof the respondent acted wrongfully and negligently.

[38] 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 acknowledged that he was well acquainted with the Sharemax product, but failed to explain it to complainant;

b) Would have found out that The Villa promotion was 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 investors returns bearing in mind that the latter owned no assets and enjoyed no trading history and did not have any independent means of making these payments. Tthese 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 and 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. This wasstated in the prospectus and Respondent 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 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). 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).

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

[39] 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.

[40] Respondent must be judged by the standard of a reasonably competent FSP in the same circumstances. As I mentioned above, respondent must also be judged by the standards expected of an FSP with similar qualifications and experience. Then 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 a 50-year-old, unemployed person, to invest her pension 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."*

Respondent was the factual and legal cause of complainant's loss.

[41] A reasonably competent FSP, at the time of providing financial advice to client, can 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.

[42] 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 her funds.

Respondent's conduct fell short 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

H. QUANTUM

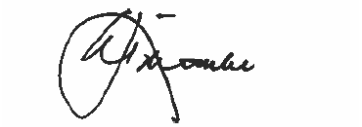
[43] Respondent invested R500 000 in The Villa. Respondent is liable for complainant's loss of capital.

I. 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 R500 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 is to cede her 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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OMBUD FOR FINANCIAL SERVICES PROVIDERS