FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS-03323-13/14 KZN 1

27 July 2017

MR BE GRIFFITHS

MIDCOAST FINANCIAL SERVICES (PTY) LTD

Per email: bgriffiths@midcoast.co.za

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Dear Mr Griffiths

DEBBIE GIRONI V MIDCOAST FINANCIAL SERVICES (PTY) LTD (first respondent) and BRUCE EARL GRIFFITHS (second respondent). RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT (37 of 2002)

A. INTRODUCTION

1. Complainant, Ms Gironi, filed a complaint with this Office during July 2013, following what she terms inappropriate advice by respondent which led to the loss of her capital.

2. The funds were invested with Sharemax The Villa Retail Park Holdings Limited (The Villa Ltd), a property syndication scheme promoted by Sharemax Investments (Pty) Ltd, (Sharemax) on the basis that her funds would not only be safe, but a sure way of realising capital growth.

Delays in finalising this complaint

3. Sometime in September 2011, after the Office had issued the *Barnes* determination[1], the respondent in that matter brought an urgent application to set aside the determination[2]. Before the fate of the application could be known, respondents sought an undertaking from this Office that it would not proceed to determine any other property syndication related complaints involving them.

[1] See E Barnes v D Risk Insurance Consultants FAIS-06793-10/11 GP 1

[2] Respondent claimed that section 27 of the FAIS Act was unconstitutional

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4. Since no legal basis was provided for respondents' demands, the Office proceeded to determine further property related complaints involving the respondents. In response, respondents launched an urgent application for an interdict to stop the Office from filing the determinations in court until the main application had been disposed of. The decision in the main application was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[3].

5. Following the decision of the High Court, which essentially dismissed the respondent's application, the Office continued to determine complaints involving property syndications. However, in 2013 following the *Siegrist* and *Bekker* determinations[4] and the relevant appeal, a decision was taken by the Office to halt processing property syndication related complaints. The decision was not taken lightly, but it was a necessary risk management step. In both determinations, the Office sought, for the first time, to hold the directors of property syndication schemes liable for complainants' losses. The said appeal was finally decided in April 2015[5], after which the Office resumed (with due regard to the decision) processing complaints involving property syndications. As many as 2000 (mainly property syndication related) complaints had to be shelved pending the decision of the Appeals Board.

B. THE PARTIES

6. Complainant is Debbie Gironi, an adult female whose full particulars are on file with the Office.

7. First respondent is Midcoast Financial Services (Pty) Ltd, registration number 2000/006698/07, duly registered in terms of South African law. The Regulator's records indicate first respondent's last known address as 20 Hosking Road, Wembley, Pietermaritzburg, 3201. First respondent was an authorised financial services provider with license number 17641. The license lapsed during April 2011.

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3 Gauteng High Court Division, case number 50027/2014

4 See in this regard FAIS-00039-11/12 and FAIS-06661-10/11.

5 See in this regard the decision of the Appeals Board date 10 April 2015.

8. Second respondent is Bruce Earl Griffiths, an adult male sole proprietor and representative of first respondent. The Regulator's records indicate respondent's address as 20 Hosking Road, Wembley, Pietermaritzburg, 3201. At all material times, second respondent rendered financial services to complainant. I refer to first and second respondents as respondent. Where appropriate I specify which respondent is being referred to.

C. THE COMPLAINT

9. During March 2009, complainant sought advice from respondent in respect of her two children's education fund for which she had been diligently saving whilst working abroad as a teacher. The funds at the time were placed in a Stanlib money market account. Complainant wanted to better the returns, without risking her children's savings.

10. During April 2009, complainant, on advice of respondent invested R300 000 in The Villa. In terms of the agreement the investment would generate interest at the rate of 11% per annum. Initially, the investment delivered as promised, and during September 2009, complainant invested a further R300 000 in The Villa with the agreed interest rate set at 11.5% per annum.

11. During April 2010, second respondent contacted complainant, advising her that there was a lucrative "early bird" opportunity in Sharemax The Villa which could probably sell out in a day. According to the respondent this was a 'sure thing' and a quick way to create additional income to boost the existing educational savings funds. Respondent explained that the money would be tied up for only 3 months with a corresponding return of 12 % where after the funds would be returned to the complainant's money market account. As the investment was only available for a short period, respondent indicated that there was a rush to sign forms and transfer the money. The complainant agreed and a further amount of R600 000 was invested in April 2010.

12. Complainant indicated that there was never any talk about risk in the investments. Her only concern however, was the investment term as she wanted to utilise the funds for high school and university fees. Respondent knew this and assured complainant of the safety of her investments, which after the April 2010 investment, stood at R1 200 000.

13. Complainant received only one interest payment in respect of the hasty R600 000 investment. The last interest payments received on the first two investments were in July 2010. From August 2010 onwards, complainant made several telephonic enquiries in respect of the outstanding payments. Respondent repeatedly told complainant that the negative press and sensational journalism were to blame for Sharemax's problems but assured her that payments would be restored. For a period of two years following the last payments, respondent continued to promise complainant that all would be resolved to no avail. Complainant subsequently received an e-mail from respondents stating that second respondent joined Momentum (in a representative capacity) and would no longer provide any further advice concerning Sharemax products; that second respondent no longer had a responsibility towards his Sharemax clients by virtue of his employment contract with Momentum.

14. Second respondent subsequently closed his business and refused to answer calls claiming that he had been medically boarded due to stress. Complainant was led to believe that respondent's investor book was bought by Momentum. To date however, complainant has not been contacted by anyone from Momentum.

15. At the time the transactions were concluded, complainant was unemployed and supported by her husband. She offered swimming lessons to supplement their income.

16. Complainant considers her capital as lost. She blames respondent for the loss.

D. RESPONDENT'S VERSION

17. In compliance with Rule 6 (b) of the Rules on Proceedings of the Office of the Ombud, the Office referred the complaint to respondent on 6 September 2013, advising respondent to resolve the complaint with his client. No response to the notice was received.

18. On 26 May 2015, the Office addressed correspondence to respondent in terms of Section 27 (4) of the FAIS Act, informing him that the complaint has not been resolved and that the Office had intentions to investigate the matter. Respondent was invited to provide the Office with its full case, together with supporting documents in order for the Office to begin its investigation. The letter invited respondent to deal with the question of appropriateness of advice, taking into account the

risk involved in the investments and how it matched complainant's circumstances. No response to this letter was received, nor did respondent ever submit any supporting documentation.

E. INVESTIGATION

19. Respondent was provided with a third opportunity to respond to the section 27 (4) notice on 16 March 2017. The letter reads (omitting for now words and sentences not material to the essence):

19.1 Property syndications are high risk investments for a number of reasons, because they are structured as unlisted companies, and the basis upon which the properties are valued are never fully disclosed.

Did you confirm the valuation figures shown in the prospectus with the cited property valuer?

19.2 Investors such as complainant are at risk as unlisted shares and debentures are not readily marketable; the value is also not readily ascertainable. Should the company fail, this may result in the loss of the investor's entire investment.

Did you explain this to your client?

19.3 The prospectus of The Villa makes it plain that Sharemax was the promoter, the company secretary, property manager and manager of investor funds.

Given the overwhelming conflict of interests, what steps did you take to ensure that your client will not be short-changed by the directors?

19.4 The prospectus informs potential investors that there is essentially no independent board of directors. Given that there was no independent board of directors (as provided for in King III), what steps did you take to satisfy yourself that your clients will be protected against director misconduct? Given the absence of an independent board, how were you going to ensure that investor funds are used for what they were meant for and within proper governance prescripts?

19.5 Given there was no audit committee and no audited financial statements, what information did you take into account to conclude that the investment was viable?

19.6 What steps did you take to understand the risk involved in the product? Please attach supporting documentation to demonstrate the information you considered.

20. Respondent was requested to submit the necessary evidence in compliance with the Code and the Act. No response was received. Complainant's version is clear and unequivocal; she has not received any money from Sharemax since August 2010.

F. ANALYSIS AND RECOMMENDATION

21. It cannot be disputed that the parties had an agreement that respondent would render advice to complainant. That advice, without a doubt, had to meet the standard prescribed in the FAIS Act and the General Code, such that a violation of the FAIS Act and the Code on the part of respondent would amount to a breach of his contractual duties.

22. Section 2, part II of the General Code of the Conduct (the Code) states 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.

23. Section 8 (1) (a) to (c) of the General Code states that:
"A provider other than a direct marketer, must, prior to providing a client with advice -
(a) take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice;
(b) conduct an analysis, for purposes of the advice, based on the information obtained;
(c) identify the financial product or products that will be appropriate to the client's risk profile and financial needs, subject to the limitations imposed on the provider under the Act or any contractual arrangement…"

24. Section 9 of the Code requires a provider to maintain a record of the advice which record must reflect the basis on which the advice was given, and in particular:
(a) a brief summary of the information and material on which the advice was based;
(b) the financial products which were considered;

(c) the financial product or products recommended with an explanation of why the products selected, is or are likely to satisfy the client's identified needs and objectives;"

25. The questions posed in the notices in terms of section 27 (4) sent by this office to respondent had their answers grounded in the prospectus, such that, if respondent had read it, he would have understood that the investments were not suitable for complainant who was looking for a safe investment. I refer in this regard to the attached annexures A1, A2, and A3 being summaries of the The Villa Ltd prospectus, the Sale of Business Agreement, and Government Notice 459, (Notice 459) as published in Government Gazette 28690.

The Villa Ltd

Violations of Notice 459

26. From the onset, paragraphs 3.2 and 3.1.1 of the prospectus make it clear that the directors of Sharemax, who also were directors of all the other Sharemax companies involved in the prospectus had intentions to violate Notice 459.

27. Section 4.3 makes provision for the disbursement of investors' funds to pay for the entire shareholding in The Villa Retail Shopping Investments (Pty) Ltd (The Villa (Pty) Ltd) from Sharemax. There is no detail as to how this benefited investors. In the same section (4.3) the prospectus discloses that investor funds will be paid out to the seller of the immovable property via a sister company, namely, The Villa (Pty) Ltd and later to Capicol 1, well before the transfer of the immovable property into the name of the syndication vehicle.

28. The movement of the funds was illegal and a direct affront to the very legislation that was meant to protect investors. I conclude that respondent must have been oblivious to the risk and could not have appropriately advised complainant in that case.

Conflict of interest

29. The prospectus does not hide the universal role of the promoter, highlighting that investors would have no protection whatsoever as the directors would only be accountable to themselves. The

investors were therefore at the mercy of the directors. Respondent seems to have overlooked this fact.

30. I refer also to the conflicting provisions of the prospectus (see paragraphs 19.10 and 4.3). First, paragraph 19.10 states that funds collected from investors would remain in the trust account and investors would be paid their return from the interest accumulated therefrom. Paragraph 4.3 on the other hand conveys that the funds would not remain in the trust account long enough since 10% would be released after the cooling off period of seven days to pay commissions. The aforesaid is confirmed in the forms that complainant had completed to make the investment. This payment too, was in violation of the Notice.

31. Two problems arise with the proposition that the investor's return was paid from the interest generated by the trust account:

31.1 At the time, interest payable by the bank on investments made in line with section 78 (2A) did not go beyond one digit. In fact, this office obtained information that the interest payable at the time was between 6.4% - 8.25%[6]. Sharemax promised between 11% and 11.5 %.

31.2 The prospectus is unequivocal that the funds would not stay in the trust account long enough to have accumulated any significant interest since it was withdrawn, firstly after seven days to fund commissions and subsequently, to fund the acquisition of the immovable property.

32. The prospectus issued by The Villa refers to a Sale of Business Agreement (SBA), concluded between The Villa (Pty) Ltd and the developer Capicol 1 (Annexure A3). Two types of payments are dealt with in the SBA. These are payments to the developer, and agent Brandberg Konsultante (Pty) Ltd. (Brandberg).

Payments to Capicol

33. According to the agreement, investors' funds were moved from The Villa Ltd to The Villa (Pty) Ltd and advanced to the developer of the shopping mall. At the time of releasing the prospectus of The Villa,

[6] http://www.fidfund.co.za/banking-options/credit-interest-rate-history/ accessed on 20 July 2017.

Sharemax had already advanced substantial amounts to the developer in line with this agreement[7]. A brief analysis of the business agreement reveals:

33.1 No security existed for the loan and this is clear from reading the prospectus and the agreement.

33.2 The prospectus states that the asset was acquired as a going concern, but the building was still in its early stages of development.

33.3 At the time the funds were advanced to the developer, the immovable property was still registered in the name of the developer. Although the prospectus mentioned the intention to register a mortgage loan, there is no evidence that this was done.

33.4 The developer paid interest of 14%, from which Sharemax took 2% and paid the remaining 12% to the investors of The Villa.

33.5 The agreement is devoid of detail relating to the assessment of the developer's credit worthiness.

33.6 No detail is provided to demonstrate that the directors of The Villa had any concerns about the Notice 459 violations.

33.7 There are no details regarding the economic activity that generated the 14% return paid by the developer.

33.8 The only rational conclusion is that the interest paid to investors came from their own capital.

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

Payments to Brandberg

[7] Paragraph 4.23 of The Villa prospectus

35. An entity known as Brandberg was paid commission in advance. The commission is said to have been calculated at 3% of the purchase price of R2 900 000 000, according to the SBA. There are no details of how these payments benefited investors. No valid business case is made as to why commission had to be advanced, in light of the risk to investors. There was also no security provided against this advance to protect the investors' interests.

G. FINDINGS

36. As demonstrated in this recommendation the investment carried with it serious financial red flags that were apparent from the onset. These should have led a reasonable person in the position of respondent to take steps to mitigate the risks. In this regard, respondent had to observe the provisions of sections 8 (1) (a) to (c) when he made recommendations to complainant. There is absolutely no evidence that respondent had appreciation for the risk involved in these investments, which leaves this Office to conclude that respondent's advice was inappropriate.

37. On the basis of the reasoning set out in this recommendation, the risks in the investments were not disclosed, in violation of Section 7 (1). The section calls upon providers other than direct marketers to provide "a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision".

38. Respondent further violated the Code in terms of section 2, 8 (1) (a) to (c) and section 9.

39. As a consequence of the breach of the Code, respondent committed a breach of his agreement with complainant in that he failed to provide suitable advice. Respondent must have known that complainant would rely on his advice as a professional financial provider in effecting the investment in Sharemax.

40. By virtue of respondent's inability to understand the risk inherent in these investments, the representations made to complainant were incorrect and in violation of section 3 (1) (a) (vii) of the

Code[8]. There is no doubt that had the complainant been made aware of the risks involved in these investments, she would not have invested in Sharemax.

41. It stands to reason that the respondents caused the complainant's loss, which loss must be seen as the type that naturally flows from the respondents' breach of contract.

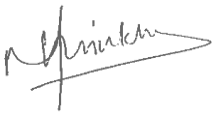
H. RECOMMENDATION

42. The FAIS Ombud recommends that respondent pay complainant's loss in the amount of R1 200 000. Each investment represents a separate and distinct cause of action. Thus, the Office has jurisdiction to consider the whole amount of R1 200 000.

43. Respondents are invited to revert to this Office within TEN (10) days with their response to this recommendation. Failure to respond with cogent reasons will result in the recommendation becoming a final determination in terms of Section 28 (1) of the FAIS Act.

44. Interest at the rate of 10.25 % shall be calculated from a date SEVEN (7) days from date of this recommendation.

Yours sincerely



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ADV M WINKLER

ASSISTANT OMBUD

[8] *"must, as regards all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein and payable to the product supplier or the provider, be reflected in specific monetary terms: Provided that where any such amount, sum, value, charge, fee, remuneration or monetary obligation is not reasonably pre-determinable, its basis of calculation must be adequately described;.."*