FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS 08794/12-13/ KZN 1

8 December 2017

ATTENTION: Mr Johann Liversage

Liversage Financial Services

Per email: ejsage@mweb.co.za

Dear Mr Liversage

Mr Denis Roy Cunningham (complainant) v Johann Liversage t/a Liversage Financial Services (respondent). Recommendation in Terms of Section 27 (5) (c) of the FAIS ACT, (ACT 37 of 2002)

A. INTRODUCTION

1. On 13 February 2013, Mr Denis Roy Cunningham (the complainant) filed a complaint with this Office against Johann Liversage t/a Liversage Financial Services (respondent). The complaint arose from failed investments made by complainant, on respondent's advice, into two public property syndication schemes, namely, Rivonia Square Shopping Mall Holdings Limited [1] ("Rivonia Ltd"), and Mont Rouge Residential Estate Development Fund Ltd[2] ('Mont Rouge Ltd"), both promoted by Sharemax Investment (Pty) Ltd ("Sharemax").

2. Respondent had been complainant's financial advisor for approximately 20 years prior to the investments made in Sharemax. Complainant claims -and it has not been denied by respondent -that there was a relationship of trust between them. Complainant trusted the advice respondent provided.

[1] Registration number 2007/007432/06
[2] Registration number 2006/007778/06

Delays in finalising this complaint

3. I find it important to address the delay in finalising this complaint. Sometime in September 2011, after the Office issued the *Barnes* determination[3], the respondent in that matter brought an urgent application to set aside the determination[4]. 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.

4. Since no legal basis existed for respondent's demands, the Office proceeded to determine further property related complaints, to which respondents replied with an urgent application for an interdict to stop the Office from filing the determinations in court, and issuing further determinations against them. The decision was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[5].

5. The Office continued to determine complaints involving property syndications after the High Court decision. However, in 2013, following the *Siegrist* and *Bekker* determinations[6] 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 was a precautionary and necessary risk management step, as the Office had for the first time sought to hold the directors of property syndication schemes liable for complainants' losses. The said appeal was finally decided in April 2015[7], after which the Office resumed processing complaints involving property syndications, with due regard to the decision. As many as 2000 complaints had to be shelved pending the Appeals Board decision.

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

4 Respondent claimed that section 27 of the FAIS Act was unconstitutional

5 Gauteng High Court Division, case number 50027/2014

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

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

B. THE PARTIES

6. Complainant is Mr Denis Roy Cunningham, an 86 year old adult male pensioner whose full particulars are on file with this Office.

7. Respondent is Johann Liversage, a sole proprietor, trading under the name and style of Liversage Financial Services. Respondent is an authorised financial services provider (FSP) with licence number 1734. According to the regulator's records, respondent's business address is No.2 Lantau, 58 Anthony Road, Umgeni Park, 4051, KwaZulu Natal. The licence has been active since 26 November 2004.

8. It appears from the Regulator's records that at the time these transactions were concluded, respondent was not licensed to render financial services in connection with unlisted shares and debentures, which are categorised as 1.8 (described in the FAIS Act as Securities and Instruments: Shares) and category 1.10 (described in the FAIS Ac as Securities and Instruments: Debentures and Securitised Debt) respectively. Respondent only became licenced with respect to these two categories on 11 January 2010.

C. THE COMPLAINT

9. Two investments were made by complainant following advice by respondent. Respondent advised complainant that the investments were safe; complainant would realise a far better income from Sharemax than what was offered by insurance companies and that in the event of unforeseen expenses, complainant could sell his shares and recoup cash. In other words, the investments were liquid and complainant's capital was not threatened. The funds invested came from a Liberty Life Capital Bond Income policy from which complainant was receiving income of R6000 monthly. Prior to the Rivonia Ltd investment, complainant had previously invested R500 000 into Comaro Crossing Holdings Ltd ('Comaro Ltd'), also a syndication promoted by Sharemax. The amount had been withdrawn from, existing Liberty[8] policy five months before it matured. At that stage the Liberty policy had capital of R730 000. Complainant states that he had sold his business and was no longer

[8] Prior to the investments made into Sharemax, complainant had purchased a Liberty Life Capital Bond Income Option Policy ('Liberty Life policy') based on the recommendation of respondent

working, and so it was important for him to receive a regular income from a liquid and risk-free investment. All of this is information respondent had access to or had been aware of.

10. In April 2007 following maturity of the Comaro Ltd investment with R538 000, complainant was advised to re- invest R500 000 in Rivonia Ltd, which was the third and final investment made into Sharemax.

11. Complainant's main aim was to secure an income during retirement and be able to access the investment should any unforeseen expenses arise. The representations of safety and liquidity were again repeated by respondent and complainant was advised that it was a medium to long term investment that would guarantee both his income and capital. However, complainant would be able to dispose of his shares at any point should he require cash. The Rivonia investment was thus effected on 12 April 2007. Respondent guaranteed complainant that he would receive a monthly income of 9%, which would escalate on an annual basis.

12. The second investment was effected on 18 July 2006, prior to the investment in Comaro Ltd having matured, in the amount of R200 000 into Mont Rouge Ltd after respondent had advised him that he would receive a return of 18% per annum over a period of 5 years. Complainant has never been able to access any of the R200 000 capital invested.

13. In respect of both investments (Rivonia Lt and Mont Rouge Ltd), complainant claims he was never advised of the risks involved, nor was he offered other alternatives. He also claims he was never provided with the prospectus. Complainant has confirmed that he no longer receives any income payments from Rivonia Ltd and considers both investments lost. He has asked this Office to hold respondent liable for the loss of his capital and order him to pay back his R700 000, the capital sum of the Rivonia Ltd and Mont Rouge Ltd investments, based on what complainant terms inappropriate advice, which involves respondent's failure to advise complainant of the risk involved in the property syndication investments.

D. RESPONDENT'S VERSION

14. Respondent's response was received on 17 July 2013 following our rule 6 (b) letter of 25 January 2013, and a reminder sent on 12 June 2013. The response is summarised below:

14.1 A copy of respondent's proposal for this investment has been provided and it describes the investment as a Property Investment Trust that provides an avenue for the smaller investors to invest directly in property through the acquisition of shares. The complainant is portrayed as the co-owner of the property in that he would acquire shares from the property trust, the entity that owns the property. The proposal furthermore promises a monthly income of 10% derived from rental income, which would escalate at between 7%-10% per annum, in addition to a capital growth of 7%. There is absolutely no reference to the risks involved in such an investment.

14.2 Contrary to the claims made by complainant, respondent claims to have provided complainant with a copy of the prospectus. It is also claimed that complainant, after reading the prospectus was hesitant with regards to the risks posed by the investment and that respondent and a consultant from Sharemax had met with complainant to address his concerns. I have noted the statements by respondent that there would appear to be a dispute of fact with regards to whether or not complainant had been provided with a prospectus.

Complainant does not dispute the presence of Mr. Koekemoer from Sharemax, who he claims had provided assurance in relation to the liquidity of the investment, complainant however claims not to have been provided with any prospectuses, and that none of the risks had ever been disclosed. In my view however, nothing turns on this as respondent has not provided this Office with any information that would suggest that complainant was placed in a position to understand the prospectus and make an informed decision.

14.3 The Comaro Ltd investment matured during 2007 and respondent claims that it had been complainant's explicit instructions to redeem only the capital growth of R38 275, and for the R500 000 to be reinvested into the next available syndication.

14.4 Respondent states that complainant was therefore provided with the prospectus for the Liberty Mall syndication, and that no other options had been provided as the decision to reinvest in Sharemax had been the complainant's. The Liberty Mall syndication had however, been fully subscribed at that time and complainant was allegedly provided with a prospectus for Rivonia Square Ltd. Complainant then invested into the Rivonia Square Ltd syndication on 10 July 2007.

14.5 There is absolutely no documentation provided in accordance with provisions of the General Code of Conduct for Authorised Financial Services Providers and Representatives ('the Code') that would indicate why this investment was deemed to have been appropriate in terms of the complainant's risk profile and financial needs. There is neither a record of the advice provided to complainant, nor any record to support what disclosures had been made with regards to the investment and the risks involved. This Office was simply provided with a copy of the signed application form and the prospectus.

14.6 The very same response is provided for the investment made into Mont Rouge Ltd, into which complainant had invested R200 000 on 18 July 2006 which was made for the sole purpose of capital growth and for which no income was required. As noted in the Rivonia investment, no documentation was provided that would indicate why this investment was deemed to have been appropriate for the complainant, taking into account his risk profile, financial needs and personal circumstances as required by section 8 (1) (a) to (c) of the General Code, (the Code). Once again this Office was simply provided with a copy of the signed application form and the prospectus.

14.7 Respondent states that he completed due diligence on the promoters of the property syndication, Sharemax, and the manner in which the investments were structured. Respondent says that he had established that no bond was registered against the properties and that there were external attorneys and auditors appointed.

14.8 Respondent was also of the view that he had been with Sharemax from the beginning and that his clients had all earned good returns and that, as the investment was in fixed property through shares in an unlisted company, he did not view it as a high risk. This is despite the warning on page 1 of the prospectus[9] which states:

*"It is important to understand that this Offer has been designed for medium to long term investment and that participation involves risk to both capital and earnings. You should also be aware that an investment under this Prospectus is not liquid as the ability to transfer Shares is restricted by the absence of a market for those shares. Neither the Company, nor any of its directors, officers or associates guarantees the replacement of capital, the payment of income or the performance of any of the Company's investments" (*own underlining).

14.9 Respondent also confirmed in the following statement *"I informed Mr Cunningham that he was invested into a share of a fixed property."*

14.10 Respondent also claims to have informed complainant that Sharemax would pay his commission and that no commission would be deducted from the investment as the promoter paid the commissions. This is in stark contrast to the extracts of the prospectuses which are detailed below and in the annexures.

14.11 In conclusion respondent attributes the failure of Sharemax to the actions of the South African Reserve Bank and a slowing down of the worldwide economy which had impacted on property.

E. INVESTIGATION

15. This Office sent 2 separate notices to the respondent, on 16 July 2016 and again on 9 June 2017, in terms of section 27 (4) of the FAIS Act, (the Notices) informing respondent that the complaints had

[9] Mont Rouge Ltd

not been resolved and that the Office had intentions to investigate the matter. The second letter sent read (omitting for now words not material to the essence):

15.1 Property syndications are high risk investments for a number of reasons, let alone the fact that they are structured as unlisted companies. The basis upon which the properties are valued are never fully disclosed. Did you ever confirm the valuation figures shown in the prospectus with the cited property valuer? What was the response of the valuer in relation to the figures quoted for the buildings?

15.2 Investors such as the complainant are at risk, as unlisted shares and debentures are not readily marketable and the value is also not readily ascertainable. Should the company fail, which ultimately occurred, this may result in the loss of the investor's entire investment. Did you explain this to your client?

15.3 The prospectus of Rivonia Square Ltd and Mont Rouge Ltd makes it plain that Sharemax (as an example) 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 of the syndication?

15.4 The prospectus further 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?

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

15.6 You may be aware that Government Notice 459 of Gazette 28690 mandates that investor funds must be kept in a trust account until registration of transfer into the name of the syndication vehicle, or upon agreement with an underwriter, whose name must be made

public. Given that the prospectus makes it clear that investors' monies will be advanced to a developer, what made you recommend the product to your client, in the face of this high risk?

15.7 We would like you to spell out the steps you took to understand the risk involved in this product, including how you appraised your client of these risks?

15.8 What information did you rely on to conclude that this investment was 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.'

16. Respondent was invited to substantiate his answers with documents compiled at the time of providing advice to his clients.

17. Respondent has despite repeated requests and follow-ups from this Office not provided a response to the Section 27(4) notices, the last being a telephone conversation with the writer hereof on 23 November 2017 accompanied by an e-mail confirming that he was satisfied the response provided to this Office on 17 July 2013 and that there was nothing further to add.

F. ANALYSIS

18. On his own version, which was corroborated by the complainant, respondent confirms that he rendered financial services to complainant. It cannot therefore be disputed that in rendering financial services to complainant, respondent had to align his conduct with the Code. The following sections of the Code are germane to this case:

18.1 Section 7 (1)(a), which 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*'.

18.2 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.

18.3 Section 8 (1) (a) to (c) of the 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…"

18.4 Section 9 (1) (a) to (c) of the General Code states that:

"A provider must, maintain a record of the advice furnished to a client as contemplated in section 8, 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 product or products selected, is or are likely to satisfy the client's identified needs and objectives; " (own underlining and italics)

19. The facts that have not been denied by respondent indicate that his client had instructed him that he could not afford to lose his capital. In his recommendation to the complainant, respondent recommended the investments in Sharemax with the full understanding that his client had no

capacity to absorb high risk. Respondent is also on record to this office stating that for various reasons, he did not view the Sharemax investment as high risk. See in this regard respondent's response of 17 July 2013, in particular paragraph 14.8 of this recommendation.

20. I demonstrate in the following paragraphs that respondent's advice was fundamentally flawed in that none of the schemes guaranteed investor capital. If anything, the prospectuses of all the schemes into which complainant's funds were invested made it plain that the investments were far too risky because of, amongst other things, poor governance practices and the conflict of interest. The directors of Sharemax, the promoter, wore too many hats and this should have signalled trouble for investors; however, respondent ignored these. The investments therefore, were not appropriate for the complainant who required a guarantee of his capital and income. In that case respondent had no basis to invest complainant's funds into the schemes. His recommendations were either a result of incompetence or lack of skill, in which case respondent was negligent in recommending investments he could not comprehend, or recklessness; in the event respondent appreciated the magnitude of risk involved in the investments and nonetheless went ahead with his recommendation even though he could see that the investments were in violation of section 8 (1) (c) of the Code. Either way, respondent violated his duty to act with skill, care and diligence as provided for in section 2 of the General Code.

Rivonia Square Ltd Prospectus

Violations of Notice 459[10]

21. From the onset, paragraphs 4.3 of Rivonia Square Ltd made it plain that the directors of Sharemax, who also were directors of all the other Sharemax companies involved in the prospectus, had no intention to comply with Notice 459 referred to hereunder as the Notice.

22. In this regard, the prospectus made provision for disbursing investors' funds to pay for the entire shareholding of the Rivonia Square Shopping Mall Investments (Pty) Ltd, (Rivonia (Pty) Ltd), from

[10] Note that the essence of paragraphs 4.3 in Rivonia Square Ltd prospectus offended Notice 459.

Sharemax. There is no detail of the concomitant benefit for investors and neither is the full purchase price noted anywhere in the prospectus.

23. The prospectus further discloses (in paragraph 4. 3) that investor funds will be paid out to the sellers of the immovable properties. The funds were to be paid over to Apex HI Properties Ltd[11] via Rivonia Square Ltd, well before registration of transfer of the immovable properties into the names of the syndication vehicles.

24. The movement of the funds was illegal and a direct affront to the Notice (see Annexure A3, which contains a summary of the Notice). The respondent says nothing about the infringement of the Notice. I conclude that respondent must have been oblivious to the risk and could not have appropriately advised complainant in that case.

Conflict of interest

25. The prospectus does not hide the ubiquitous role of the promoter. Note that there is no evidence that there was ever an independent board of directors, nor is there evidence that there ever were independent audit, risk and remuneration committees in the entire group of Sharemax. It is fair to conclude that, right from the start, investors would have no protection whatsoever as the directors would only be accountable to themselves. In simple terms, the investors were at the mercy of the directors. This too, does not appear to have attracted respondent's eye.

Conflicting provisions of the prospectus

26. I refer also to the conflicting provisions of the prospectus; in this regard paragraphs 19.10 and 4.3. First, paragraph 19.10 states that funds collected from investors would remain in the trust account in terms of section 78 2 (A) of the Attorneys Act. Investors' returns will be paid from the interest generated by the trust account. Paragraph 4.3 of the prospectus however, conveys that the funds would not stay long enough in the trust account as at first, 10% would be released after the cooling off period of seven days to pay commissions. The same statement is made in the application forms

[11] Reg no 1999/000238/06

that clients had to complete in applying for the investment. This payment too was in violation of the Notice.

27. There are two problems with the proposition that the investor's return was paid from the interest generated by the trust account. They are:

27.1 At the time, the 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 5.9% - 7%[12].

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

I note that the Prospectus states that the interest payable on the claim component of the unit, will be determined from time to time by the directors[13].

Mont Rouge Limited Prospectus

28. The directors of Mont Rouge Ltd (the company, into which complainant's funds were invested), were the same as the directors of Sharemax the promoter, company secretary and the transfer secretary[14]. In addition to the preceding information, Dominique Haese, also a director of Sharemax, was both a director and company secretary of Planet Waves, the developer[15].

29. There is no evidence 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. No evidence of independent oversight existed, which makes the protection of investors questionable. The structure and arrangement of these companies, all of which appear to have been controlled by

[12] http://www.fidfund.co.za/banking-options/credit-interest-rate-history/
[13] See paragraph 9.3.1
[14] Paragraphs 3.2, 3.9, and 2.11 of the prospectus

[15] Paragraph 3.13 of the prospectus

the same people suggests that investors would have no protection whatsoever as the directors would only be accountable to themselves.

30. The risk in this investment was further heightened by the following:

30.1 The directors of the Company had borrowing powers of 5% of the directors' bona fide valuation of the net asset value of the Company and its subsidiary, from time to time[16]. No evidence exists that the respondent had taken any step to verify the valuation of the property with any other property valuer. Neither is there evidence of the date of such valuation. The risk of over-valuation was not excluded, therefore, notwithstanding the potential harm to investors.

30.2 Interest on the debenture component will be paid at a rate determined from time to time by the directors[17]. Debentures that, according to paragraph 33.2 of the prospectus, were unsecured.

30.3 It is apparent from respondent's version that he had never had sight of audited financial statements of this company.

30.4 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. Respondent therefore 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.

[16] Paragraph 3.5

[17] Paragraph 9.3

31. The prospectus[18] further states that the Company (Mont Rouge Ltd) intended to utilise the proceeds of the offer, being R31 700 000 to:

31.1 Advance to the developer, Planet Waves, an amount of R25 600 000, to purchase the immovable property and to complete the project successfully.

31.2 Pay the costs of the Offer[19], which included fund raising commission and Promoter's fees.

31.3 Pay the operating costs of the company[20], which included the director's fees and expenses.

31.4 Provide an opportunity for investors to participate in the growth potential of the Company, Mont Rouge Ltd.

32. Given the lack of oversight structures and the conflict of interest, it is difficult to see how investors would be protected against abuse of their funds while the disbursements were made as set out in paragraphs 33.1 to 33.3.

33. Paragraph 13.3 in the prospectus states that the Company may pay commission to intermediate service providers and their representatives at a rate dependent on the amount invested, but will not exceed 10% of the capital raised. This was certainly not disclosed to complainants and marks a breach of the Code.

34. From the preceding paragraphs, one can rationally conclude that not only did respondent fail to appreciate that he did not possess the capabilities to assess the risk inherent in this product, he was happy to promote a product he did not understand to complainants. Even if complainants were provided with a prospectus, it is unlikely that they would have understood it, nor would they have appreciated the risk involved in the Sharemax investments.

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[18] Paragraphs 8.1 and 8.2 of the prospectus

[19] Paragraphs 16.14.1 and 16.15.

[20] Paragraph 16.14.2 of the prospectus

G. FINDINGS

35. On the basis of the reasoning set out in this recommendation, as well as respondents own admission that he did not view these investments as high risks, respondent failed to appropriately advise complainant.

36. Respondent violated Section 7 (1) which states that providers other than direct marketers must 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*".

37. Respondent further violated the Code in terms of section 8 (1) (a) to (c) and section 2. Respondent in his response with regards to the Rivonia Square Ltd syndication concedes to the following: "I did not show him any other option. The decision was his." Respondent failed complainant in so doing. It was his duty in terms of the Code to advise complainant and point him to an investment that would suit his particular needs, risk profile and objectives.

38. As a consequence of the breach of the Code, the respondent committed a breach of his agreement with complainant in that he failed to provide suitable advice. The respondent must have known that complainant, after a relationship of almost 20 years, would rely on his advice as a professional financial services provider in effecting the investment in Sharemax.

39. The representations made to complainant were incorrect and in violation of section 3 (1) (a) (vii) of the Code. There is no doubt that had the complainant been made aware of the risks involved in these investments, he would not have invested in any of the schemes.

H. CAUSATION

40. The question that must be answered is whether respondent's flawed advice caused complainants the loss. Had respondent complied with the Code and sought investments that were in line with

complainant's circumstances, there would have been no investments in any of the schemes. Such a conclusion is rational based on the circumstances of this case. Respondent must have known that his client was going to rely on his recommendations in making the investment. It stands to reason that the respondent caused the complainant's loss, which loss must be seen as the type that naturally flows from the respondents' breach of contract.

I. RECOMMENDATION

41. The FAIS Ombud recommends that respondent pay complainant's loss in the amount of R700 000.

42. The respondents are invited to revert to this Office within TEN (10) working 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[21].

Yours sincerely

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Marc Julio Alves
Team Resolution Manager

[21] "*The Ombud must in any case where a matter has not been settled or a recommendation referred to in section 27(5)(c) has not been accepted by all parties concerned, make a final determination, which may include-*
(a) the dismissal of the complaint; or
(b) the upholding of the complaint, wholly or partially…."