

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

CASE NUMBER: FAIS 6793/10-11/GP 1

In the matter between:-

ELISE BARNES

Complainant

and

D RISK INSURANCE CONSULTANTS CC

1st Respondent

DEEB RAYMOND RISK

2nd Respondent

**DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY
AND INTERMEDIARY SERVICES ACT NO. 37 OF 2002 ('FAIS ACT')**

A. THE PARTIES

[1] Complainant is Elise Barnes, a female, retiree of Parkhurst, Johannesburg, Gauteng Province.

[2] First Respondent is D Risk Insurance Consultants CC, a close corporation duly incorporated in terms of South African law, with its principal place of business at 60 Van Riebeeck Avenue Edenvale, Gauteng Province. First

respondent is an authorised financial services provider in terms of the FAIS Act, with license number 12806. The license was issued on 25 November 2004.

- [3] Second Respondent is Deeb Raymond Risk, a male of adult age, a key individual and representative of the 1st respondent. Second respondent is the authorised representative of 1st^t respondent. At all times material hereto, complainant dealt with 2nd respondent.

B. BACKGROUND

- [4] On 3 November 2010, complainant lodged a complaint with this Office. The gist of the complaint is set out in the complaint registration form. It reads:-

'a) As a pensioner, I was persuaded to buy Sharemax shares by Deeb Risk. This is a high risk investment which was never disclosed to me. I am unable to sell my shares in Sharemax and redeem my capital and no interest has been paid since 1 September 2010.....'

- [5] As part of the complaint, complainant also included a letter she had earlier addressed to respondent regarding her investment in Sharemax. The letter forms part of the complaint and is dated 8 October 2010. According to complainant, sometime during October 2008, at the age of 69, she was advised by respondent to invest in a Sharemax scheme known as the Zambezi Retail Park, (Zambezi). At the time, the markets were extremely volatile and her money was in the money market. In recommending the investment, respondent stressed that interest rates were coming down. He

further gave complainant the assurance that her investment would be paid out within one year as there was a buyer for the Zambezi Retail, (Zambezi). Based on respondent's advice, complainant invested an amount of R1.4 million into Sharemax Zambezi on 2nd December 2008.

- [6] Complainant states that the only reason she agreed to invest was the assurance that the investment would be returned within one year. During the discussion, respondent is alleged to have offered no alternative investment to the Sharemax investment.
- [7] In May 2009, complainant once again invested an amount of R400 000 in Sharemax in a scheme known as Sharemax, The Villa. She sought and obtained from respondent the assurance that her initial investment of R1. 4 million would be paid by end of the year in 2009.
- [8] During November 2009, complainant contacted respondent by phone to ask about the investment. Respondent is alleged to have told complainant that there was a slight delay but that she should not worry as her investment would be returned by March/April 2010.
- [9] Sometime in early 2010, with her initial investment not paid, complainant phoned respondent on three occasions expressing concern and unhappiness about the investment.
- [10] A further point raised by complainant is that according to a risk profile done by respondent, prior to the first investment, she was said to be a 'low moderate' in terms of risk whilst the profile done in respect of the second investment indicated that she was in fact a 'moderate. She wanted respondent to explain

how her profile changed from being a 'low moderate' to 'moderate'. There is also a further allegation made by complainant that the investments in Sharemax were not in her interests. Complainant in this regard, points to what she calls high commission plus bonuses and the high risk involved in the product sold to her.

[11] During September 2010, complainant contacted respondent wanting to know how she should plan to fund her monthly requirements. To this, respondent is alleged to have told complainant she has other monies therefore there should be no problem.

[12] Complainant is further of the view that she has lost her capital of R1.4 million and R400 000.

C. COMPLAINT

[13] The complainant's complaint may be summarised as follows:

[13.1] Following advice by respondent complainant invested an amount of R1.4 million into Sharemax Zambezi. A further investment was also made based on the advice of respondent into Sharemax, The Villa, in the amount of R400 000. The amounts were invested as two separate transactions. In recommending the investments respondent is alleged to have failed to properly advise complainant in that he failed to make material disclosures including risk and liquidity as required by the General Code of Conduct, (the Code).

[13.2] Respondent is also alleged to have failed to comply with the requirement that providers act in the client's interest when rendering

financial services. In this regard, complainant pointed to the commission received by respondent of 10% while her investment was placed in a high risk investment.

[13.3] As a result of respondent's failure to render financial services in compliance with the Code, complainant states, she has lost her capital of R1.4 in respect of the investment in Zambezi and R400 000 in respect of the Villa. Complainant holds respondent liable for the loss of her capital.

D. THE RELIEF SOUGHT

[14] The complainant has asked for the payment of the amount of R800 000¹ in respect of the investment in Zambezi and the full R400 000 in respect of the investment in The Villa. This determination however, only deals with transaction pertaining to the Zambezi.

E. RESPONDENT'S VERSION

[15] Prior to the complaint being lodged with this Office, respondent wrote back to complainant acknowledging her complaint of 8 October 2010. Respondent's letter is dated 21 October 2010 and is addressed to complainant. It reads, that the matter had been forwarded to his professional indemnity insurers who have instructed '*me not to respond to you at this stage until the matter has been fully investigated, as this will be contrary to my policy conditions.*'

¹ Complainant has agreed to abandon R600 000 in order to bring the amount of the damage within the jurisdiction of this Office.

[16] On 17 November 2010, in terms of Rule 6 (c) of the Rules on Proceedings of the Office, the complaint was referred to respondent affording him opportunity to resolve the complaint with his client. His response to this Office was due on 29 December 2010. The letter further outlined the process the Office would follow in the event the complaint was not resolved. Respondent acknowledged receipt of the complaint on 24 November 2010. On 8 December 2010, respondent successfully requested an extension to file his response. On 10 January 2011, respondent filed his response which he termed 'response in the form of an application in terms of section 27 (3) (c) of the FAIS Act.' In this application, respondent also attached supporting documents relating to the rendering of the financial service. What follows is a summarised version of the response. The response can be divided into two sections. One section deals with the merits of the complaint and other deals with whether the Ombud is the appropriate forum to deal with the complaint. I summarise the response to the merits:-

[16.1] Respondent acknowledges that he has been a financial advisor to the complainant for the past eleven years. During this period both he and complainant have actively monitored her investment portfolio, made changes from time to time, taking into account market conditions and her personal circumstances.

[16.2] He has assisted complainant from time to time with her provisional and normal tax and that she (complainant) continuously sought his advice on numerous other financial matters, which advice he gladly provided to her. Complainant retired in 2005. At this point, adjustments were

made to her portfolio to ensure that she could start receiving a monthly income.

[16.3] Complainant is well versed in financial matters. She took active part in her investment portfolio. At times she would instruct respondent to make a particular change or investment. It was clear to respondent from the questions posed by complainant to him that she had a clear understanding of how financial markets work. Complainant had never complained about bad advice or bad service until the Sharemax issue arose.

[16.4] Respondent is accredited by Sharemax to market its products and the latter is an authorised financial services provider.

[16.5] On 2nd December 2008, respondent discussed investing R1.4 million in the Zambezi with complainant as it was paying an excellent income of 12 % per annum until September 2009 and thereafter 10 % per annum. The investment opportunity was discussed in detail with complainant, particularly, prospectus No 10 of Sharemax Zambezi Retail Park Holdings Limited. Respondent is satisfied that complainant fully understood the investment and the contents of prospectus 10. Complainant then instructed respondent to invest R1.4 million in respect of prospectus 10.

[16.6] Complainant confirmed that she was fairly knowledgeable on the product in which she was investing. She confirmed she had taken into consideration that Sharemax had a ten - year track record at the time of her investing. She also confirmed the investment was a long - term

one. In this regard, respondent refers to a form titled 'Life and Investment Client Advice Record', which was signed by complainant. The form is marked annexure "C".

[16.7] Respondent further refers to a document titled personal portfolio risk profile questionnaire, which complainant completed on 2 December 2008. The document is marked annexure "D". In this document, complainant confirms that she is aware that 20 to 30% of her current total net worth would be invested in Sharemax. Respondent then annexes a document which confirms complainant's investment into Sharemax for R1.4 million.

[16.8] During the 25 or 26 May 2009, respondent once again met with complainant wherein they discussed a further investment into Sharemax in the amount of R400 000. This investment was in respect of prospectus No 7 of the Villa Retail Park. Respondent confirms that a copy of the prospectus was given to complainant and discussed in detail. Respondent states, 'again, this document includes an investment risk assessment.'

[16.9] Respondent has attended a number of seminars presented by Sharemax over the years and is *au fait* with its projects. All Sharemax projects have performed exceptionally well. They had an established track record and when complainant invested he had no reason to doubt the success of the projects. Both Zambezi and the Villa paid interest to complainant until September 2010. For reasons unknown to respondent, interest payments ceased.

[16.10] Respondent denies that the Sharemax investments were done in his best interests. At all times, he considered complainant's needs, interests and requirements. In his view complainant fully understood all the discussions they had and agreed with the recommendations.

[16.11] Respondent denies that there was high risk attached to the investment.

[16.12] Respondent further states that there are obvious discrepancies and disputes between the versions of the complainant and his on essential events. These factual disputes cannot be determined on unattested and untested conflicting versions of events made on paper. Oral evidence on oath and cross examination are required in order for the finder of fact to determine the truth.

[16.13] Respondent further states that in February 2010 again, complainant approached him to invest R100 000 over a period of five years. He completed a risk assessment. Respondent refers to a document marked "I", a copy of the risk assessment. Complainant then subsequently terminated his mandate to act as financial advisor on 26 October 2010.

[16.14] About the legality of Sharemax Model and the events surrounding the Villa and the Zambezi, respondent states that when he assisted complainant to invest in the Villa and Zambezi, he was not aware of any questions regarding the solvency and the legality of the business model of the two. It was only about August / September 2010 that he learnt through the public media that the Villa and Zambezi had

defaulted on the interest payable to investors. He then followed the events surrounding the two in the press.

[16.15] He believes that the South African Reserve Bank, (SARB) has appointed judicial managers for the Villa and Zambezi and that eminent persons, Justice Hartzenberg and well respected economist Mr Dawie Roodt have been appointed to its board of directors. His understanding is that every attempt is made to complete the projects to prevent losses. At this point, it is unknown whether the Villa and Zambezi will recommence payment of interest and completes the projects or whether the two will fail or even be liquidated. Whether or not any investor will lose his or her investment and if so what the loss may be are questions the answers to which are unknown. In respondent's view, no decision concerning any compensation claimed by complainant from him may be made before it is determined whether the Zambezi and the Villa will fail.

[16.16] Respondent finally submits no decision can be made concerning his negligence on the grounds alleged by the complainant, unless it is established whether or not the Sharemax model was legal, what the causes of the non payment of interest were and what was in the public domain when he discussed the investments with complainant.

F. ISSUES

[17] There are three issues here:-

- a. Jurisdiction of this Office;
- b. Whether respondent in rendering financial services failed to comply with the Code.
- c. In the event it is found that the respondent failed to comply with the Code, whether such conduct caused the damage complained of.

a) Jurisdiction

[18] Respondent has raised the point that there are obvious discrepancies and disputes between the versions of the complainant and his, on essential events. These factual disputes cannot be determined on unattested and untested conflicting versions of events made on paper. Oral evidence on oath and cross examination are required in order for the finder of fact to determine the truth.

[19] It is perhaps necessary to revisit the complaint, the gist of which is set out in paragraphs 14.1 and 14.2 of this determination. The allegations made include amongst others, the movement of complainant's funds from a money market investment into Sharemax Zambezi and the Villa. A further allegation made points to non disclosure of material aspects of the financial products sold, including risk and liquidity whilst rendering the financial service. All of the allegations made by complainant are matters of compliance with the Code. These are matters that can and are answerable by records maintained by the financial services provider.

- [20] There is no question whether respondent rendered financial services to complainant. That much is clear. He has further gone to great lengths in annexing to his response documents pertaining the rendering of the particular financial services.
- [21] In terms of section 15 of the FAIS Act, respondent as an authorised financial services provider is bound to comply with the Code when rendering financial services to clients. What remains to be seen is whether the records furnished by respondent support his case. This in my view is the essence of the complaint.
- [22] In terms of section Part XI of the Code which deals with complaint resolution by financial services providers in particular section 19 (1), respondent as an authorised financial services provider must have an internal complaint resolution system and procedures, which must amongst other things make provision that - after the receipt and recording of a particular complaint, the complaint will as soon as practically possible be forwarded to the relevant staff appointed to consider its resolution, and that-*'the client is informed of the results of its consideration within the time referred to in Rule 6 (b) of the Rules: Provided if the outcome is not favourable to the client, full written reasons must be furnished to the client within the time referred to in Rule 6 (b) of the Rules, and the client must be advised that the complaint may within six months be pursued with the Ombud whose name, address and other contact particulars must be simultaneously provided to the client.'*
- [23] Rule 6 (b) (i) and (ii) of the Rules on Proceedings of the Office obliges any respondent, who cannot within three weeks or receipt of a complaint resolve

the complaint to the satisfaction of the complainant, to inform the complainant that he or she may refer the complaint to this Office, and if the complainant so wishes to pursue the matter, he or she should do so within six months of receipt of such notification. Rule 6 (c) obliges this Office to inform the respondent against whom a complaint is lodged to the extent necessary to respondent thereto fully. Rule 6 (d) requires the respondent to act professionally and reasonably and to cooperate with a view to ensuring the efficient resolution of the complaint.

[24] A response unfavourable to the complainant as set out in paragraph 16 of this determination was furnished to complainant. The response however, is in violation of Rule 6 (b) (i) & (ii) and section Part 19 XI of the Code, both of which are binding to the respondent. Notwithstanding, complainant found her way to this Office. There is no material dispute of fact here. It follows that this Office has jurisdiction to entertain the complaint and the respondent is therefore required to cooperate professionally and reasonably with a view to ensuring the efficient resolution of the complaint.

b) Whether in rendering the financial service to complainant respondent failed to comply with the Code.

[25] Several issues have been raised by the complainant. These are:

- a) the movement of complainant's funds from the money market into Sharemax;
- b) non- disclosure of material aspects of the investment including risk and liquidity; and

c) the failure to properly advise her.

(i) Replacement of a financial product

[26] There is no dispute that complainant's funds were in the money market at the time of her discussions with respondent about Sharemax. An amount of R1.4 million was subsequently moved from the money market and invested into Sharemax. This is a replacement of a financial product. The Code provides in Part VII, section 8 (i) (d) that a provider must where the financial product is to replace an existing financial product wholly or partially, fully disclose to the client the actual and potential financial implications, costs, and consequences of such a replacement, including, where applicable, full details of- (i) fees and charges in respect of the replacement product compared to those in respect of the terminated product;(ii)....., (v) the material differences between the investment risk of the replacement product and the terminated product, (vi) penalties or unrecovered expenses deductible or payable due to termination of the terminated product, (vii) to what extent the replacement product is readily realisable or the relevant funds accessible, compared to the terminated product.

[27] I have no doubt that the respondent, having handled complainant's affairs for the past eleven years, would have been aware that the investment into Sharemax was a replacement. I have perused all documents submitted to this Office and nowhere is there a comparison in respect of fees and charges for the terminated and replacement product. I have also seen no comparison in

respect of liquidity and risk as the section demands. I now deal with the Life and Investment Client Advice Record, (Client Advice Record), Annexure "C".

[28] Perusal of the Life and Investment Client Advice Record marked "C", furnished by the respondent, indicates the following:-

- (i) In a section titled **A: Summary of information used**, the form sets out the client's objectives: The response set out reads, '*Income and Capital Gain on Investment*'. The next line asks for the financial situation of the client: The response written reads, '*Retired and rely on investment and annuity income.*' The next line asks for current product experience: The response reads, '*Fairly knowledgeable.*'
- (ii) **Section B: Needs/Goals Identified:** The following appears, Need identified, quantified and to be addressed: is *Post Retirement Income* set out as priority number 1. Risk profile is identified as '*medium*' and the review date is indicated as '*yearly.*'
- (iii) **Section C, which is titled: Products Considered (list those products on which quotes/fund fact sheets have been obtained)**, the response reads, 'Sharemax Zambezi Retail Park.'
- (iv) **Section D, Recommendation/Advice & Motivation (ensure all needs identified in section B are addressed)**. The following appear: First, the recommended product is '*Zambezi Retail Park*'. The motivation is set out as: (1) '*No upfront fees or charges to the investor*', (2) '*Lump sum investment*', (3) '*Sharemax Preferred Provider with a 10yr track record*'.

- (v) **Section E: Important information highlighted to client (eg, risks, tax implications, liquidity, legislative restrictions, exclusions, consequences of replacement, etc):**This is what appears in the document: (1) *'Medium to long term Investment. No monies can be redeemed before sale of property.'* (2) *'All rental or interest Income taxable. In terms of the current legislation up to R28 000 tax rebate'.* (3) *'Sale of property subject to capital gains tax. First R100 000 capital gains tax free and balance to 10 % tax'* (4) *'penalty of 5 % payable within 12 months of purchase or subject to finding new buyer.'* **Section F: Financial Adviser's Declaration:** The client has elected not to accept the following product recommendations: *'money market'*. For the following reasons: *'Interest rates to decline and the capital appreciates'*. The consequences thereof have been clearly explained to the client. The response *'Yes'* appears.
- (vi) The last page of this document contains **Section G: Client Declaration.** *'(Pls note that it is of utmost importance that you read this section carefully and understand fully. All blocks must be initialled by the client to indicate acceptance)'*. Of importance here is Block 4 which reads. *'The quotation (s) for the product (s) selected was shown to me and the principal terms and conditions explained to me. I have been informed of and understand all costs, charges, penalties, liquidity limitations and tax implications where applicable. I understand the risks/guarantees (or absence thereof) associated with the products and or underlying funds elected. Block 5: I confirm that the financial Advisor has made enquiries to ascertain*

whether the product (s) selected are intended to replace any existing financial products held by me and where applicable, has informed me of the financial implications, costs and consequences of replacement. Block 6. I understand that, where conducted, the accuracy of a Needs Analysis is dependent on the information obtained or provided to the Financial Advisor'. In respect of all these blocks, complainant has signed.

[29] The form purports to be a record of advice but it does not comply with the requirements of section 8 (1) (d) in the following respects:-

- a) There is no indication that the respondent was dealing with a replacement and no comparison of the terminated and replacement product appears anywhere in the form.
- b) The only product considered under the section C, is Sharemax Zambezi Retail Park and the only product recommended is Sharemax Zambezi Retail Park.

(ii) Liquidity

- c) An investment in a money market is liquid in that it is accessible generally within three to five days. On the other hand, the investment in Sharemax Zambezi, is described by the respondent in section E of his record of advice, annexure 'C' as a medium to long term investment. He further states, no monies can be redeemed before sale of property. In the same section, respondent states that there shall be a 'penalty of 5 % payable

within 12 months of purchase or subject to finding a new buyer.'(my emphasis) This means complainant may redeem her investment within 12 months but the penalty of 5 % will be applicable or subject to finding a buyer.

- d) According to Prospectus No. 10 pertaining to Zambezi, paragraph 4.6 makes it clear that claims are repayable only in the event of winding up of the company or on disposal of the immovable property. Paragraph 5.15 which deals with the resale of shares states ' *...an investment in Immovable Property must be regarded as a long-term investment, usually not less than five years. The recommended investment period is therefore not less than five years..... When Sharemax assists investors to dispose of their Units, Sharemax will charge a market- related cost of sale which will not exceed 10 % plus Vat and which will not be less than 5 % plus Vat of the selling price of such Units.*'
- e) Paragraph 5.16 states that '*Investors should note that there is a substantial risk in that the investor may not be able to sell his shares should he wish to do so in the future.*'
- f) Paragraph 5.3.2 states: '*.....Sharemax shall not provide any assistance in this regard to investors if such sale is to take place within the first 24 months of the investment.*' Paragraph 5.3.3 draws the investor's attention to the fact that it is not the function of the promoter to find a buyer should the investor wish to sell his shares.
- g) The prospectus is clear, the investment must be looked at as a long term one with a minimum period of five years. The record of advice instead

contains a sweetener that a penalty might be applicable in the event complainant sells within the first 12 months. This is not what complainant is contracting for in terms of the prospectus. On respondent's own version none of the material issues pertaining to liquidity contained in the prospectus were disclosed to complainant.

- h) The Code requires providers to disclose material aspects of the product in such a manner that clients are in a position to make an informed decision. The record should speak for itself that this element of the investment was disclosed. It does not.

(iii) Risk

- On a perusal of the Client Advice Record, annexure "C" complainant's risk profile is set out as "Medium". Another important document in this regard is the Risk profile questionnaire, annexure "D" of respondent's response. Page 1, section A of annexure "D", in particular point 1 asks the question: 'What is the primary purpose of this investment? Seven possible answers are listed and each answer is given a score. (scores are set out in bold) They are:
- To provide security of capital – **3**
- Medium term savings (time horizon 3-5 years) – **5**
- Long term savings (time horizon over 5 years)- **13**
- Wealth accumulation over the long-term (time horizon over 10 years) -

- Retirement planning if under 45 years - 21
- Retirement planning if between 45 & 55 years - 12
- Retirement planning if over 55 years – 8 (is the answer chosen)

[30] Question No.3 states, '*I will need the money*'. The answer chosen is between 1 and 3 years. Complainant is given a score of 3 for this answer. On page 2 section B headed "Investment Experience", question 5 asks, *Based on your investment goals, which of the objectives profiled below best describes your desired investment approach?*. A few possible answers are suggested. The answer selected states: 'seeking growth of capital over the medium- term and prepared to accept only moderate levels of risk. For this answer, complainant got a score of 13.

[31] At this point it is necessary to point a few inconsistencies in the two documents: The personal risk profile records the primary objective of the investment as retirement planning. In the same risk profile it is recorded that complainant will need her capital in a period indicated to be between 1-3 years. On page 2 of the same document, complainant's investment approach is said to be seeking capital growth over the medium term and prepared to accept only moderate levels of risk. Medium term in respondent's version is a period between 3-5 years. The advice record however, states that complainant is in the investment for a medium to long term. In her version, complainant stated she was informed that her capital would be returned within one year. This is consistent with the information in the risk profile which says she will need the funds within one to three years.

[32] There are inconsistencies between the need to access capital within one to three years, the chosen objective of seeking capital growth over a medium term, access with a penalty of 5 % in the first 12 months and the statement that complainant acknowledged that the Sharemax investment is medium to long term. If this is what respondent meant in his reply by stating that complainant acknowledged that the investment was a long term one, it follows that respondent is responsible for confusing his client instead of appropriately advising her. The probabilities favour complainant's version that she was told that the investment would be returned within one year. A prudent provider acting with the requisite skill care and diligence would have at this point noted the glaring inconsistencies, sought clarity from his client and advised her accordingly.

[33] Annexure "D", question 6 asks, have you ever invested in equities or equity funds? The response selected is yes. Complainant scores 10 for this answer. Question 7 asks, did you understand and feel comfortable with the level of risk involved, the answer is yes with a corresponding 10 for a score. These questions are misleading. On the other hand they show respondent's lack of understanding of what he was actually selling to the public. Feeling comfortable about having a portion of one's funds invested in a unit trusts for example or any widely diversified equity portfolio with the majority of companies involved having underlying assets is one thing, as opposed to investing in an unlisted single stock share which, as one shall see has absolutely no assets and even questionable as to whether it would ever end up owning anything given the convoluted structure of the companies involved.

[34] There are inconsistencies between the advice record and risk profile in that complainant there is said to be a medium risk. In the risk profile she is a low to moderate risk.

[35] I do not deem it necessary to deal with the remaining three questions as it is clear that by completing this form, respondent was simply going through the motions and not necessarily advising his client as the Code demands. The two documents do not make sense when read together. If this is what respondent meant by stating he did a risk profile for the client, he has missed the point. This is his client, he knows what she has and what she is dependent on, and that is retirement income. He knows what assets complainant has. He should also know how sensitive complainant would be in risking capital of R1.4 million. The questions about how comfortable complainant was with equities and whether she has ever invested in equities do not make sense. He should know. The resultant score of 85 which comes with a description that complainant is an assertive to medium risk investor comes as no surprise. First, he does not explain what he means by an assertive to medium risk investor. This is exactly the result respondent sought in order to sell complainant the investment, whether it made sense or not, whether it was inconsistent with complainant's circumstances or not. I also need to point out that the two investments in Sharemax Zambezi and the Villa constituted 30 % of complainant's total net worth. Further, an investor comfortable with equities or a fairly knowledgeable one (as respondent describes complainant) would not describe herself as a low to medium risk taker. Respondent should have clearly seen the discord and not continue with the sale. He did because right from the start, he had intended to sell the

complainant the Sharemax investment whether this was consistent with complainant's circumstances or not. Respondent's conduct violated the Code in this regard.

Risk inherent in the Sharemax Zambezi investment

[36] As I begin this analysis, I am reminded of the sage words of Schutz JA, as he then was in the matter of *Durr v Absa*² where he said:

'Hindsight is not vouchsafed the common man as he picks his course through life. This must be kept constantly in mind in a case like this one, where all is so obvious now.....'

The analysis of the prospectus of Zambezi Retail Park No. 10 however, reveals the following to have been apparent from the start:-

- (i) Page 4 of the prospectus opens with the warning that the shares on offer are unlisted and should be considered as a '**risk capital investment**', my emphasis. Investors are therefore at risk as unlisted shares and claims are not readily marketable and should the company fail this may result in the loss of the investment to the investor. I have not seen anywhere in respondent's papers that he warned complainant that she could potentially lose her capital. I have no doubt complainant would not have invested in this investment if she was told she could lose her capital of R1.4 million. This is material. A provider acting in the client's interest would not put 30 % of his client's net worth

² 1997 3 ALL SA 1

at risk especially given that complainant is a retiree and will not have access to capital again.

- (ii) On page 4, it is stated that the offer by Sharemax Zambezi Retail Park Holdings Limited is for a subscription for 126 000 linked units. Each unit consists of 1 ordinary par value share of 0,00001 and one **unsecured floating rate claim** with a value of R999,9999 linked together in a Unit at R1000 per unit by way of a public offer. I have not seen anywhere in the record of advice that complainant was aware that she was investing in an unsecured floating rate claim. I also have not seen anywhere that the legal implications of this type of investment were disclosed to her.
- (iii) **The parties:** The Company is described as Sharemax Zambezi Retail Park Holdings Limited. For convenience, I refer to this company as (Holdings). The promoter is Sharemax Investments (Pty) Ltd, (Sharemax). Then there is Sharemax Zambezi Retail Park, (Pty) Limited company, (Zambezi Retail). Page 14, paragraph 4 deals with the history and state of affairs of the company and its future subsidiary. It is stated in the paragraph that Holdings was registered in 2006. Holdings have never traded before registration of the prospectus and has not made any profit whatsoever. Sharemax owns 100 % of Zambezi Retail. The latter is the entity that concluded the sale of business agreement with Capicol (Pty) Ltd. It was meant to be the eventual owner of the immovable property.

- (iv) The directors of Holdings, Sharemax and Zambezi Retail are the same. The company secretary for Holdings is one of the directors. In terms of paragraph 3.3 which deals with appointment of directors, the four directors of Holdings, will constitute the board of directors until the first annual general meeting, thereafter members of the Holdings shall appoint directors to the board, provided that the promoter shall have the right to have at least three directors on the board for the first five years after date of registration of the prospectus. The number of directors shall not be less than three and not more than five.
- (v) I have not seen anywhere that it was disclosed to complainant that she was investing her retirement capital in a company that has never traded before. Precisely what matched complainant's risk profile to an investment in a company of such high risk has not been disclosed by the respondent. All he has done is deny that this is a high risk investment. This, despite the warning appearing on page 4 of the prospectus he claims to have discussed with complainant. Here is the point, in the record of advice, annexure "C", reference is made to a ten year track record of Sharemax. Exactly what respondent was referring to in this regard is unclear. Given that this is what was sold to complainant, it was misleading. Complainant needed to know that she was investing her retirement funds into a company that has never traded and no track record to talk of.
- (vi) Respondent has made much of complainant's investment being in property. I have not seen anywhere that complainant was made aware that Holdings, the unlisted public company into which complainant's

funds went into, had only one asset, the shareholding in a private company, Zambezi Retail. Herein lies the danger, private companies do not have their affairs being subject to public scrutiny. They are not obliged to have their financial statements publicised. They are also not subject to the myriad of compliance and regulatory checks as publicly listed companies are. All three companies are said to be controlled by the same people. The promoters, Sharemax, have even gone as far as ensuring that at least three of their directors will be there for five years from date of registration of the prospectus. A provider acting with due skill and in the interest of his client would have asked himself, if the two major players, namely the two private companies are controlled by the same persons, how is accountability, transparency going to be enforced and how is investor protection going to be ensured. Respondent could not have applied his mind to this.

[37] Respondent does not appear to have ever questioned how governance and risk to investors is to be managed given that all the three companies are run by the same individuals. No mention in his records of what risk mitigating factors he took into account given that Holdings had never traded before

[38] Page 18 of the prospectus, paragraph 4.3 states that the company, referring to Holdings, will operate as a holding company and intends utilizing the proceeds of this tenth offer to:-

- (i) Pay part of the purchase price, being R20 963 910.00 in respect of the entire shareholding in Sharemax Zambezi, purchased from Sharemax for an amount equal to 16.64% of the purchase price to be paid by

Sharemax Zambezi for the business. It then goes on to say an amount of R83 856 640 has already been raised for this purpose through issuing the nine prospectuses.

(ii) Holdings also intends to advance an unsecured loan funding in the amount of R100 000 000.00 to Zambezi Retail for the purpose of paying part of the purchase price which is to be paid to purchase the immovable property from Capicol. The purchase price is projected at R930 000 000. It is stated in the document that the actual purchase price will be calculated thirty days after the date of occupation.

(iii) Precisely why investors' funds had to be utilised to pay Sharemax for Zambezi Retail's shareholdings and what it is that investors received, is unclear. Paragraph 29 of the prospectus states that the eventual borrower of the monies raised through the claims will be the Zambezi Retail, the private company. Here we have the debtor and creditor being substantially the same person. Exactly what questions respondent raised with regard to the projected purchase price remains a mystery and the purpose behind the unsecured loan also remain unclear. It is fair to conclude that respondent never read the prospectus for if he read and understood prospectus No. 10, he would have appreciated the risk complainant was facing.

(iv) Respondent has further mentioned that when he assisted complainant to invest in the Villa and Zambezi he was not aware of any questions regarding the solvency and legality of the business model of the two. It was only about August / September 2010 that he learnt through the

media that the Villa and Zambezi had defaulted on the interest payable to investors. In actual fact, the funding model of Sharemax is contained the contained in the prospectus and the solvency inferences can be made from there. Had he read and understood the prospectus he ought to have appreciated the deficiencies. In *Durr v Absa*³, the court had the following to say:

‘One of the first requirements of a professional is to know when he may be getting out of his depth, so that I do not think that that is sufficient excuse. I am not able to say exactly what Stuart should have done. But I would suggest that there was a point at which he should have walked down the passage or across the street or lifted the telephone, or activated the fax, and said to a lawyer or accountant, or banker (none of which he was) in the employ of Absa, something like this. “Look, I have been introduced to some attractive debentures (preference shares) in a group called Supreme. Would you please tell me quite what debentures (preference shares) are, and how secure they are. And also, please tell me how I find out who and what Supreme is and what risks attaches to investing in it” ’

On respondent’s own version, he was negligent. It was his responsibility to conduct due diligence and not rely on what is available publicly. As I mentioned in this determination, a mere reading of the prospectus alone would have led to complainant investing her money

³ *Supra* page 97

elsewhere. It is clear by now that respondent lacked resources to evaluate an investment of this nature.

- (v) It is respondent's case to this Office that the investment was not high risk. It is evident from the prospectus which he supposedly discussed with complainant that this was in fact a high risk investment. Respondent's assertion that complainant knew that this was a medium to long term investment is also undermined by his own record where it is indicated that his client will need her funds within 1 to three years. It is contradicted by his version that the funds are accessible within one year subject to a 5 % penalty. If respondent did not understand the product he was selling he could not have been in a position to disclose any of the material aspect of the product to complainant. Complainant needed to know that she is in this investment for a long term, in a high risk investment, unequivocally.

The application form

(i) Disclosure of costs

- [39] The advice record, annexure "C" states in section D that the investment is recommended because there are no upfront fees or charges to the consumer. The application form dated 2 December 2008, states clearly in paragraph 15 that upon payment to the attorneys of the purchase price for the units and once the cooling off period has lapsed, an amount equal to 10 % of the invested amount will be released to the promoter to be utilised by them for the payment of commission. Units to the value of the full investment amount will

however be issued to the investor because the promoter will eventually pay all commission.

[40] Paragraph contains two things, the reality and a promise of the promoter. The reality is, the investors' funds are utilised to pay commission, upfront. This according to the Code must be disclosed. On respondent's version, the 10% commission he earned was not disclosed. Then there is the promise that the promoter will eventually pay all the commission on some future date that is not mentioned.

[41] Respondent mentions in the client advice record annexure "C" that there are no upfront charges to be borne by the investor. This is in fact another indication that respondent had superficial knowledge of the product. The prospectus spells out that part of the money being raised is going to be utilised for various things, amongst which is the payment to Sharemax for the entire Shareholding in Zambezi Retail. Against this payment, it does not appear anywhere what value the investors would have received. He does not appear to have questioned whether it made economic sense or not for investors to be paying money for shareholding in Sharemax Zambezi. Here is the answer, paragraph 5.9 of the prospectus spells it out that the investors are in fact paying for marketing fees.

(ii) Sharemax Investment Risk Assessment on Product Information

Respondent has in his reply made specific reference to this form. According to the introduction appearing on this form, the form is to be completed by the

investor in the presence of the financial advisor. The purpose is to ensure that the investor understands all benefits and risks involved in the investment. Before I deal with the form in detail, it needs to be pointed out that the complainant would not have learnt anything about the risk inherent in the Sharemax product by completing this form. The form is devoid of any meaningful information to help the complainant appreciate the nature of the investment she purchased.

The first question in this form asks whether the advisor gave complainant the prospectus. The answer is yes. Giving a 97 page document with complicated legal terms, most of it convoluted is not compliance with the Code in so far as disclosures are concerned. The Code requires providers to disclose material aspects of the financial product so that clients make informed decisions. I have already indicated that the respondent could not have read the prospectus at all and would not have been in a position to make material disclosures. The second question asks whether the advisor informed you that this product should be seen as a medium to long term, meant for a horizon of not less than five years. The answer is yes. The answer recorded here is clearly inconsistent with risk profile which indicates that complainant would like to access her funds between one and three years. The instances of contradiction point to the fact that the provider could not have been applying his mind. I am satisfied that this is once again conduct on the part of the respondent which is designed to pay lip service to the Code as opposed to proper advice to a client.

G. FINDINGS

- a) I am satisfied that respondent failed in his duty to comply with section 8 (1) (d), given that the transaction involving the Zambezi investment was a replacement.
- b) Respondent further failed to disclose the material aspect of liquidity regarding the investment in Sharemax Zambezi. His contention that complainant knew that this was a long term investment is not supported by the facts. On the contrary, the facts support complainant's version that her funds were going to be available within one year.
- c) Respondent failed to disclose the risk inherent in the Sharemax Zambezi investment.
- d) Respondent's insistence that the investment was not high risk is untenable.
- e) Respondent also failed to make accurate disclosures to complainant as required by the Code regarding how the return was to be paid;
- f) Respondent failed to disclose costs in respect of the investment in Zambezi.
- g) Respondent failed to appropriately advise complainant in that he failed to apply his mind as to how much risk complainant could tolerate, given her circumstances. He failed to recommend a product commensurate with complainant's risk tolerance to address her need for post retirement income.

- h) Respondent failed to act with due skill, care and diligence in the interest of his client and the integrity of the financial services industry.
- i) Respondent's contention is that no decision can be made on the question of his being negligent until the question of the legality of Sharemax funding model has been decided upon. None of the issues ventilated in this determination have anything to do with that. These are matters of compliance with the Code. Respondent's contention in this regard must fail.
- j) Respondent's contention that complainant's complaint is premature as no one has answers as to whether the companies will succeed or not is also irrelevant. The issue is not whether some monies will be recovered by complainant at some future unknown date. The test is whether the advice, given complainant's circumstances was appropriate. The advice provided was patently flawed.
- k) I have found no evidence that complainant took active part in her investment portfolio.
- l) I have already disposed of the question of appropriateness of this Office to deal with this complaint. I do not deem it necessary to deal with respondent's submissions in this regard. It is clear that there is no material dispute of fact in the matter.

H. QUANTUM

[42] Complainant invested R1.4 million in the Zambezi. To bring the amount within the jurisdiction of this Office, complainant has agreed to abandon R600 000. Complainant's capital was due to be paid in year 2009. The balance of probabilities favour complainant's claim that indeed her capital was to be repaid in November 2009. It is now two years since the due date of payment. Complainant has also not been paid any income since September 2009. All of these support complainant's contention that she has lost her capital of R1.4 million. I intend therefore to make an order in the amount of R800 000 in this regard.

I. ACCOUNTABILITY

I deem it appropriate that I deal with the issue of joint and several liability of the respondents herein. I have held that the 2nd respondent failed to comply with the Code in the rendering of the financial service herein. 2nd respondent is a member and a key individual of 1st respondent. If I were to hold 1st respondent solely liable this would not be in line with what the legislature intended as evidence by section 8 of the FAIS Act. I say so for the following reasons:-

[43] In terms of section 8 (1) (c) of the FAIS Act in instances where a financial services provider is, amongst others a corporate body, the applicant for licensing must satisfy the registrar that any key individual in respect of such applicant complies with the requirements of personal character qualities of honesty and integrity; and competence and operational ability'. It is only when

the registrar is satisfied that an applicant meets these requirements, that a license will be granted.

[44] Additionally 'no such person may be permitted to take part in the conduct or management or oversight of a licensee's business in relation to the rendering of financial services unless such person has on application been approved by the registrar.

[45] Section 8 (5)(ii) additionally requires that upon the change in the personal circumstances of a key individual a registrar may impose new conditions on the licensee. From the obligations imposed on the key individual it is clear that it is the key individual himself that is personally responsible to satisfy the registrar that he is fit and proper. Authorisation of the entity is approved through the key individual himself.

[46] The fact that where the key individual does not meet the legislative requirements of fit and proper, the corporate entity's license can be withdrawn simply means the intention of the legislature is to hold both persons accountable. The General Code of Conduct for Authorised Financial Services Providers and Representatives (the Code) clearly envisages that the general and specific duties of a provider of financial services are those that are performed by a natural person as opposed to an artificial persona. This is evident in:-

- (i) the definition of provider, which includes a representative;
- (ii) the general duty of a provider in Section 2 of the Code requires that financial services be rendered with due skill, care and diligence, in the

interests of clients and the integrity of the financial services industry.

This can only be performed by a natural person;

(iii) The various specific duties regarding the rendering of a financial service set out in section 3 require human intervention;

(iv) So too all the requirements set out in Parts III, IV, V and VI;

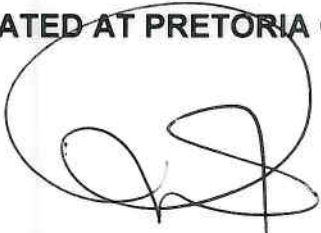
1st Respondent is the licensed provider under whose name the financial service was rendered. On his own version, 2nd respondent, according to annexure B1, is an authorised financial services provider and a key individual of 1st respondent. It follows therefore that both 1st and 2nd respondents must be held accountable.

J. ORDER

In the premises the following order is made:

1. The complaint is upheld;
2. Respondents are hereby ordered, jointly and severally, the one paying the other to be absolved, to pay to complainant the amount of R800 000,00 in respect of the investment in the Zambezi;
3. Interest at the rate of 15.5 % , from a date seven (7) days from date of this order to date of final payment;
4. Respondents are to pay a case fee of R 1000, 00 to this office within 30 days of date of this order.

DATED AT PRETORIA ON THIS THE 2nd OF NOVEMBER 2011.

A handwritten signature in black ink, consisting of several loops and a long vertical stroke extending downwards.

NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS

