IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

CASE NUMBER: FAIS 6793/10-11/GP 1 (2)

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.

[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 respondent. At all times material hereto, complainant dealt with 2nd respondent. For convenience, I refer to 1st and 2nd respondent as respondent.

B. BACKGROUND

[4] In May 2009, complainant invested an amount of R400 000 in Sharemax in a scheme known as Sharemax The Villa based on the advice of 2nd respondent. 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.

[6] According to complainant, respondent did a risk profile on her, prior to her first investment into Sharemax Zambezi. In terms of the outcome of that profile, she was said to be a 'low moderate' risk whilst the profile done in respect of

the second investment indicated that she was a 'moderate'. Complainant states that investments in Sharemax were not in her interests. In this regard, complainant, points to what she calls high commission plus bonuses and the high risk involved in the product sold to her.

[7] Complainant is further of the view that she has lost her capital of R400 000.

C. COMPLAINT

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

[8.1] Following advice by respondent complainant invested an amount of R400 000 into Sharemax The Villa. In recommending the investment respondent is alleged to have failed properly advise complainant in that he failed to disclose the risk inherent in the investment as required by the General Code of Conduct, (the Code).

[8.2] 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.

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

D. THE RELIEF SOUGHT

[9] The complainant has asked for the payment of the amount of R400 000.

E. RESPONDENT'S VERSION

[10] 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. In the letter, respondent states 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.*'

[11] On 17 November 2010, in terms of Rule 6 of the Rules on Proceedings of the Office, the complaint was referred to respondent affording him opportunity to resolve the complaint with his client. 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:-

[11.1] 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.

[11.2] 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.

[11.3] 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.

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

[11.5] During the 25 or 26 May 2009, respondent 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.'

[11.6] 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.

[11.7] 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.

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

[11.9] 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.

[11.10] 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.

[11.11] 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.

[11.12] 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 complete 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.

[11.13] 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

[12] 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

[13] 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.

[14] For the reasons set out in the 1st Barnes determination[1], in paragraph 18 to 24 this Office has jurisdiction to entertain the complaint.

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

i) the alleged non- disclosure of material aspects of the investment including risk; and

ii) the alleged failure to properly advise complainant.

i) Non disclosure of risk

[15] Respondent in his response dated 10 January states in paragraph 20 that he met with complainant and discussed the investment of R400 000. The investment was in prospectus 7 of The Villa. He then refers this Office to annexure 'F' of his papers which supports amongst other things that the prospectus 7 was furnished to complainant. Annexure F, is the Sharemax application form signed by complainant. The last page to the application is the, 'Sharemax Investment Risk Assessment on product information'. It is states that the form was introduced to ensure that the investor understands all benefits and risks involved in the investment product. The following questions are asked:

a) Did your advisor provide you with a registered prospectus? Complainant has answered yes to this question.

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b) The next question asks whether the advisor informed the investor that the product should be seen as a medium to long term investment, meant for an investment horizon of not less than five year? Complainant answered yes.

c) The third question asks whether the investor has a contingency fund for unforeseen expenses. The answer to this is yes. The last two questions deal with the choice between the two income plans an projections used. As will be demonstrated in this determination the form is devoid of any meaningful information to help the complainant appreciate the nature of the investment she purchased. I cannot see how respondent could claim to have disclosed risk by referring this Office to this form.

The risk inherent in The Villa investment

<u>The nature of the investment</u>

[16] I start by highlighting that the act of furnishing 71 year old complainant with a 106 paged prospectus written in technical jargon and several instances of reference to various sections of the document before one deciphers the real meaning of a particular clause does not amount to disclosure of risk. What the code countenances in Part II, section 3 (1) as regards information provided to a client by a provider when rendering financial services is plain language that avoids uncertainty or confusion.

[17] Page 6 of prospectus No 7 for the Villa Retail Park Holdings Limited, (the Villa) contains a caveat 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 loose her capital. I have no doubt complainant would not have invested in this investment had it been disclosed to her that she could lose her investment. This is material. When one reconciles this clause in the prospectus with respondent's purport that the investments were not high risk, it raises doubt as to whether respondent had ever read prospectus 7.

[18] On page 8, it is stated that each claim (referring to the investment purchased by complainant) represents an **unsecured floating rate claim acknowledgement of debt made by the Company in favour of the shareholder** with a nominal value of R999,9999. I have not seen anywhere that respondent disclosed to complainant that she was investing in an unsecured floating rate acknowledgement of debt and what the legal implications of this type of investment are.

[19] In the prospectus, the Company is described as The Villa Retail Park Holdings Limited. For convenience, I refer to this company as (Holdings). The promoter is Sharemax Investments (Pty) Ltd, (Sharemax). Then there is the Villa Retail Park Investments, (Pty) Limited, (The Villa). Page 16, 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 2008. Holdings has never traded before registration of the prospectus and has not made any profit whatsoever. Sharemax owns 100 % of the Villa. The Villa is the entity that concluded the sale of business agreement with Capicol (Pty)

Ltd in terms of which the Villa bought the immovable property for a projected amount of R2 900 000 000.

[20] Respondent in his response to this Office claims that amongst other things considered to conclude on suitability of the investment was the ten year track record of Sharemax. That factor could only have been raised in the context of risk. What is perturbing however is that complainant was not contracting with Sharemax the promoter. She was contracting with Holdings a brand new venture which has never traded before with no track record. These are material aspects of this investment and had to be disclosed to complainant. The fact that he led complainant to believe she was contracting with an entity with a track record of ten years was in fact incorrect and misleading. A further concerning point is that respondent has not disclosed anywhere in his papers what in terms of the risk inherent in this investment matched the risk tolerance of the complainant and her circumstances. What respondent has simply done is to label complainant as a moderate investor. Exactly how he arrived at this conclusion has not been disclosed. It is no wonder that his own client is still seeking answers to this question.

[21] The directors of Holdings, Sharemax and the Villa 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.

This should have raised questions of governance and investor protection in the mind of the respondent. He was under a duty to draw complainant's attention to this. This was not done.

[22] Respondent did not disclose to complainant that Holdings, the unlisted public company into which complainant's funds went into, had only one asset, the shareholding in a private company, Villa. Purely on the question of risk, this should have raised concerns to respondent. It does not appear to have done so. Given that the private and public unlisted companies are controlled by the same persons, respondent should have clearly disclosed this to complainant and advised her against the investment. He did not.

[23] 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 the offer to:-

Pay part of the purchase price, being R14 223 527 in respect of the entire shareholding in the Villa, purchased from Sharemax for an amount equal to 18.96% of the purchase price to be paid by the Villa for the business. It then goes on to say an amount of R44 771 052 has already been raised for this purpose through issuing the first four prospectuses.

Holdings also intends to advance an unsecured loan funding in the amount of R58 625 000.00 to the Villa 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 R2 900 000 000. It is stated in the prospectus that the actual purchase price will be calculated thirty days after the date of occupation, being 1 March 2011.

[24] First, the prospectus is silent regarding the economic benefit investors will receive by paying for the shareholding in the Villa. Respondent also did not raise any questions regarding this aspect. Second, Government Gazette No. 28690, Notice No. 459 of 2006 issued by the Department of Trade and Industry, in terms of the Consumer Affairs (Unfair Business Practices) Act, 1988, (the Gazette) is relevant here. Attached to the Gazette is Annexure A which calls for certain disclosures. The disclosures are to be made by promoters of property syndication. By extension, any provider who recommends property syndications must be aware of the disclosures when he advises clients. In terms of the Code the provider has an obligation to disclose material information to his or her client to enable the client to make an informed decision. Concerning at this point is the issue of the purchase price which according to the prospectus is projected at 2 900 000.00. Clause 6 of the Annexure to the Gazette requires amongst the disclosures to be made, :-

- the cost of the property to the promoter or the syndication company including acquisition price;
- cost of renovations, conversion or enhancement including details of any leases or lease renegotiations which enhance the value;
- marketing and promotional cost fees and the promoter's entrepreneurial mark up, giving rise to the shareholder offer price in the company as at the offer date and
- the valuation of the property, which shall not be more than three calendar months before date of the offer, undertaken by a valuer, in accordance with paragraph 10 of the Notice.

These details are necessary to enable any FSP to seriously consider whether there is any value for the investor. In addition, the FSP has the chance to consider the prudence with which the scheme is to be conducted by examining the disclosure documents in terms of the Government Notice.

[25] Paragraph 29 of the prospectus states:-

- The claims will not be listed on any exchange in the Republic of South Africa;
- The claims will be unsecured;
- There has been no material adverse change in the company's financial position since the date of incorporation;
- The company does not have any trading history and therefore no previous financial statements are available;
- The claims are issued by the company and the proceeds therefore will be used for the purposes set forth in paragraph 4.3;
- The ultimate borrower of the monies raised through the issue of the claims will be the Villa.

[26] According to the prospectus the debtor will be the Villa and the creditor Holdings. It was important for complainant to know that she was actually purchasing an investment where the debtor and the creditor are the same person. I have no doubt that had respondent had resources to evaluate the investment, the result would have been a recommendation that complainant look elsewhere to invest her retirement funds.

[27] Respondent claims 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. This submission cannot assist respondent. Even prior to the default on interest payments there was a clear indication that this investment was actually high risk and inappropriate for complainant. Respondent has not indicated what it is that informed him that this investment was appropriate for complainant's circumstances. In my view the funding model of Sharemax as well as solvency inferences are matters which a provider acting with due skill care and diligence would have inferred from the prospectus. I have raised my doubt as to whether respondent read the prospectus. Had he read and understood the prospectus he ought to have appreciated the deficiencies.

[28] On respondent's own version, he failed to comply with the Code. 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 elsewhere. It is clear by now that respondent lacked resources to evaluate an investment of this nature.

[29] On his own version respondent did not disclose the risk inherent in the product therefore, he could not have appropriately advised complainant. Based on the failure to disclose risk alone, respondent's advice was inappropriate in the circumstances and in conflict with the Code.

Findings

a) I am satisfied that respondent failed in his duty to disclose the material aspect of risk inherent in Sharemax, The Villa investment.

b) Respondent's insistence that the investment was not high risk is untenable.

c) Respondent failed to appropriately advise complainant in that he failed to recommend a product commensurate with complainant's risk tolerance to address her needs.

d) Respondent failed to act with due skill, care and diligence in the interest of his client and the integrity of the financial services industry as demanded by the Code.

e) 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. I differ. That is not the issue at all. The issue relates to the duty of a provider to act with due skill care and diligence, in the interests of the client as the code demands. Respondent's contention in this regard must fail.

f) 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 clearly inappropriate.

g) I have found no evidence that complainant took active part in her investment portfolio. On the undisputed facts, the 71 year old complainant, as active as she might be, will simply not be able to understand the contents of prospectus 7.

h) 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 further clear that there is no material dispute of fact in the matter.

Quantum

[30] Complainant invested R400 000 in the Villa. It is complainant's claim that she has lost her capital. The circumstances of this case compel me to accept her claim. An order therefore is to be made in the amount of R400 000.

G. ACCOUNTABILITY

[31] 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 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 evidenced by section 8 of the FAIS Act. I say so for the following reasons:-

[32] 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 that an applicant meets these requirements that a license will be granted.

[33] 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.

[34] 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.

[35] 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 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 B1, is an authorised financial services provider and key individual of 1st respondent. Therefore, it is necessary that I hold both respondents liable jointly and severally, the one paying the other to be absolved.

H. ORDER

In the premises the following order is made:

1. The complaint is upheld;

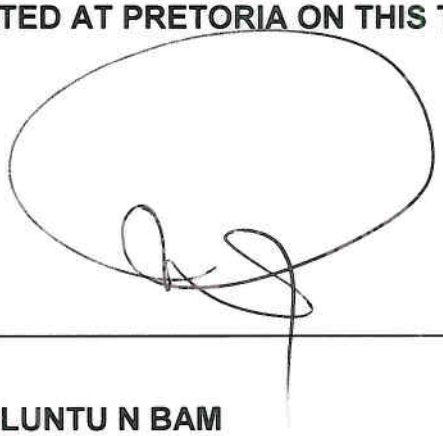
2. Respondents are hereby ordered, jointly and severally, the one paying the other to be absolved, to pay to complainant the amount of R400 000,00 in respect of the investment in The Villa;

3. Interest at the rate of 15.5 % , 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.

5. Upon compliance with the order, all rights in The Sharemax, The Villa investment are to be ceded to respondents according to payment.

DATED AT PRETORIA ON THIS THE 21st OF NOVEMBER 2011.



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OMBUD FOR FINANCIAL SERVICES PROVIDERS