IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

CASE NUMBER: FAIS 06019/08- 09/EC1

06507/08-09/EC1

In the matter between:-

GODFREY FREDERIK BOTHA	**1ST Complainant**
ELIZABETH HELEN BOTHA	**2nd Complainant**
and	
R & S WALSH INVESTMENT CONSULTANTS CC	**1st Respondent**
RONALD WALSH	**2nd Respondent**
GUY ROBERT COLEMAN	**3rd 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] First complainant is Godfrey Frederick Botha, a 76 year-old male retiree from Port Elizabeth, Eastern Cape Province.

[2] Second complainant is Elizabeth Botha, a 73 year old female retiree from Port Elizabeth, Eastern Cape Province. Complainants are husband and wife.

[3] First respondent is R & S Walsh Investment Consultants CC, a close corporation (registration number CK 1991/32249/23), duly incorporated in terms of South African law, with its registered address being 97 Main Road, Walmer, Port Elizabeth. At all material times, First respondent was an authorised financial services provider in terms of the FAIS Act, with license number 12946. The license was issued on 13 October 2004. It lapsed on 12 February 2010.

[4] Second respondent is Ronald Walsh, a male of adult age, an authorised representative and key individual of the First respondent.

[5] Third respondent is Guy Robert Coleman ('Coleman'), a male of adult age, an authorised representative and key individual of the First respondent at the time the financial service was rendered.

B. INTRODUCTION

[6] The complaint relates to inappropriate advice provided by the respondents to the complainants to invest in aggressive and risky funds that were ill suited to the complainants' personal circumstances.

[7] Getting on in life the complainants were at that stage 69 and 66 years of age respectively. They were retired and intended to draw a regular income from the investment, which was made in November 2007. The market crash of 2008 and resultant material diminution in the unit pricing of the underlying funds eventually compelled complainants to reduce and ultimately stop income withdrawals. As a result of the material reduction in the price of the underlying units, more units had to be sold to fund the complainants' withdrawals, a

position which complainants claim caused them immense stress and aggravation.

C. COMPLAINT

[8] Looking at various options to provide for their retirement income, complainants met with Second respondent during 2006. Complainants state they were very cautious of the markets as a means of investing but knew that Second respondent specialised in unit trust investments.

[9] A further meeting took place in January 2007 wherein complainants explained that they had an interest bearing investment. At this meeting they enquired from Second respondent as to whether the unit trust offered by respondent could generate a better return, to which they were advised in the affirmative.

[10] Consequently in the first quarter of 2007, following Second respondent's advice, First complainant invested R70 500, 00 and the Second complainant R97 421, 00 into an Investec platform.

[11] The underlying funds were split as follows:

11.1. Allan Gray Balanced - 60%

11.2. Allan Gray Equity – 20%

11.3. Nedbank Rainmaker – 20%

[12] A monthly income was taken.

[13] During or about April 2008 the Allan Gray Balanced and Nedbank Rainmaker portions thereof were switched out by respondent into the following funds:

13.1. Investec Commodity Fund – 34%

13.2. Investec Equity Fund – 33%

13.3. Investec Managed Fund – 33%

[14] Aside from the Investec Managed fund, which as a balanced fund holds other assets in addition to equity, the portfolio was now almost completely equity centric. In response to enquiries from the office, a Mr Nicholas Croskill from 'Compliance and Legal Investec Asset Management" stated in an e-mail dated 18th October 2010, that 'the clients were originally invested in mostly moderate risk funds but after the switch they were invested in predominantly more high risk funds.'

[15] In November of 2007 and again on respondents' advice, complainants followed up with equal investments of R500 000 each in Stanlib. They each initially withdrew a monthly income of R4 575, 00 out of their respective investments; reducing to R3 575 for the months of October and November 2008 before ceasing. Their statements reflect withdrawals as recommencing in November of 2011. The underlying funds were as follows:

15.1. Stanlib Capital Growth – 30%

15.2. Stanlib Value – 30%

15.3. Stanlib Stability – 30%[1]

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[1] The name of the Stability Fund was later changed to the Balanced Fund. In terms of the Stanlib fund fact sheet the risk rating is shown as being between Moderate and Aggressive.

15.4. Stanlib Small Cap – 10%

[16] In June 2008, and in respect of the Stanlib Portfolio the following switches were made. The Stanlib Small Cap fund was switched entirely into the Old Mutual Mining and Resources fund. In addition 20% of both the Capital Growth and Value funds were also switched into the Old Mutual Mining and Resources fund. A January 2009 fund fact sheet has the following to say about the fund: 'This fund may be riskier than a diversified general equity investment because its assets are concentrated in the mining sector of the stock exchange. In addition this fund may hold a greater risk as exposure limits to a single security may be higher than those of a general equity fund.'

[17] Overall this was an aggressive equity centric portfolio; a view reaffirmed in communication between Stanlib and this Office.

[18] The moves to both the commodity fund and Old Mutual Mining Resources funds in April and June 2008 are particularly relevant given that this was during the global financial crisis of 2008. Just as a reminder, in March 2008 the Federal Reserve Bank of the United States intervened to save Bear Stearns: Fannie Mae and Freddie Mac followed in July 2008 and on Monday the 15th September 2008 Lehman Brothers declared bankruptcy. The next day saw AIG being bailed out and investors panicking.

[19] Given the volatility of the global financial crisis many would see the April and June 2008 switches as counter intuitive because they increased risk allocation during a volatile period. In this regard by investing in a specific sector of the economy, one reduces diversification and in so doing increases risk. In this regard the Third respondent in his response offers some insight. He states that

the Second respondent met with the clients personally to re-allocate the clients' portfolio due to concerns that first complainant had over the markets. Owing to the fact that at that point the resources based sector was the only one providing positive returns, Second respondent allocated many of his clients into resource based funds. Third respondent goes on to state that the Second respondent informed the clients that this would be much more volatile but he firmly believed in this approach. It is apposite to point out that there is not a single record on file of complainants' having been so informed. As such, this would mark a violation of the General Code, (the Code) as complainants would not have made an informed decision about the move.

[20] On his version the Third respondent was outraged and contacted their compliance officers to report these actions and asked them to intervene but to no avail.

[21] Complainant himself states that his complaint is about the structure of his investments; in particular the fact that whilst he was of moderate risk in terms of his risk profile, he was invested wholly in aggressive funds, while drawing an income from an investment with no cash component to cater for those withdrawals.

[22] Complainant lists various interactions with respondent during the period April 2008 to January 2009. In short these related to his concerns regarding the market volatility and its impact on the investments particularly the monthly withdrawals. Complainant states that he was told to 'stick it out' as it did not affect the units. Further he was told that there will be a change in the markets and that he must not worry. In December of 2008 complainant, as he puts it,

‘requested to stop regular withdrawals (phone call) on my own instinct not their advice.’

[23] A letter dated 19th February 2009 addressed by complainant to both the Second and Third respondent sums up complainants’ concerns. What follows are various extracts from the letter: ‘As you are both aware the Stanlib and Investec investments I placed with you have massively devalued by approximately 50% since inception this is a massive drop in values and causes enormous stress and heartache for a pensioner for whom it is my life savings’; ‘there was also no consideration by you towards my concerns that the monthly withdrawal/income that I was taking was coming out of these aggressive and volatile funds and I was therefore “selling” units at reduced prices every month in order to make this withdrawal which meant an even greater loss”; “ should the investment have been structured correctly and not been so incredibly aggressive so much capital would not have been depleted in one year”; “ No action was taken by you to alleviate the situation and if it was not for my calls and setting up appointments not even that would have been done.”

[24] On complainant’s version income withdrawals were cancelled in November[2] 2008, at which point they started drawing from their savings. The savings were reserved for vacations, emergencies or unforeseen medical expenses, states complainant.

[25] Summary of the complaint:

[2] Last payment was in November of 2008

- Complainants claim they were invested in interest bearing investments to fund their retirement income needs. Realising they required more income, complainants sought advice on how they could improve their position.
- They spoke to respondents who advised them to place their funds in high risk investments with the promise of a better return.
- They state that the risk implications were never explained to them.
- Complainants would never have invested in such aggressive funds had they understood the volatility to which they were exposed
- Aligned thereto, complainants point out that there was no provision for short or medium term financial needs; in other words no provision for the deleterious impact on capital, which income withdrawals had during a market downturn.
- The investments were switched around by respondents with some switches being made at the height of a global financial markets downturn.
- Their fears were ignored by respondents who carried on switching their investments until their investments were essentially equity based, this whilst withdrawing income, with no allowance being made for this.
- As the value of the underlying units decreased, complainants had to sell more units to fund their income.

- Driven by the need to save their investments, complainants, on their own instincts, initially decided to reduce their withdrawals and later stopped withdrawing.
- Complainants make it clear that they kept the money in the high risk funds on the advice of the respondents.
- They claim they would never have invested in high risk funds had they known the full implications.
- Having failed to successfully resolve their complaint with the respondents, complainants filed the present complaint.

D. FIRST AND SECOND RESPONDENTS' VERSION

[26] The Third respondent has parted ways with the First and Second respondent. First and Second respondents' version: According to the two respondents, whilst the funds were moderate to high risk they were aimed at meeting complainants' investment requirements of capital growth over the long term. The changes to both the commodity and the equity funds were aimed at enhancing their clients' long term stable capital growth and income objectives, which the balanced and moderate funds were not able to meet.

[27] Accordingly this did not contravene the FAIS Act but was instead a means of meeting the clients' interests, needs and objectives, which respondents were sensitive to. They argue that there was no personal benefit to the FSP or adviser but to their clients', otherwise they would not have suggested it.

[28] Accordingly respondents argue that the financial service was rendered with honesty, due skill, care and diligence. They add that had the clients not

panicked and gone contrary to the advice given, which was to allow the markets to correct, the complainants would have recovered a significant portion of their investment. They in fact argue that this recovery would have been significantly higher and quicker than moving out of the high risk portfolios. In other words, when the recovery occurs it would be the high risk portfolios that would have benefitted the most. Accordingly the respondents argue that they cannot be held responsible for market volatility.

[29] It is pointed out that due the significant fall in the value of the portfolio, and contrary to what is implied by respondents' version above, complainants had no option but to stop withdrawals but did in fact remain invested in the suggested portfolios until December 2011. It was only at this point and after the markets had recovered to a degree that complainants restructured their portfolio with the help of another financial advisor. The First and Second respondents further contend that all necessary compliance procedures were followed in that a needs analysis was conducted to ascertain the long term needs of the complainants, namely capital growth and income. A risk profile was done to determine the complainants' ability to cope with risk (which ultimately showed they were high end of moderate); a product fitting their needs was offered with an explanation as to the implications of the product. Accordingly the complainants made an informed decision, having considered the markets for about a year before purchasing the investment. It is pertinent to point out that there is no evidence suggesting that complainants' circumstances were considered. This flows from the fact that there is no document wherein one can find details of complainants' financial standing/ assets.

[30] Included with respondents' replies was its bundle of documentation. Commencing with the minutes of a meeting between the complainants and Third respondent on the 22/1/2007, a letter on file would appear to indicate that a copy of these minutes were forwarded to complainant. The pertinent points contained therein are as follows, where necessary comment is made:

30.1. 'discussed with him corrections in the market and how the long term perspective of an investor causes those corrections to be less of a concern'. Complainants had a certain sum of money invested in the name of his wife and himself, which was invested in an interest bearing investment. The income therefrom was used to supplement their medical expenses and their monthly budget.

30.2. Complainants wished to know whether the unit trust portfolio would be able to match or better this income to which Third respondent advised that not only would it be able to match and better the income but would also be able to offer him good long term capital growth.

30.3. Third respondent went through a complete breakdown of the clients' financial needs to ascertain the portfolio best suited to the client.

30.4. This was followed up with a phone call to check on whether there was anything that complainants were uncertain with.

[31] Before going any further, advice furnished to a client must be recorded in terms of the Code. Section 9 is instructive in that it not only requires that the advice be recorded, it refers to product/s considered, the basis for the advice and reasons for concluding that the product sold is best suited to the client's

circumstances. No such record has been provided. Perhaps even more interesting is that there does not appear to have been information gathering from the documents furnished to this office.

[32] The risk profile analyser reflects First complainant as scoring 52 points, thereby placing him in the moderate risk category of the form, which ranges between 40 and 55 points. It is noted that the disclosure notice is in the name of the Second respondent.

[33] An e-mail from Third respondent to complainants dated 30th June 2008, states 'Ron and I still feel that although the market is going through a patch it will without a doubt recover'. He goes on to state that this is a long term investment and that there is no particular time frame attached to the recovery. Initialled RW[3] are some hand written notes on this e-mail stating, 'I spoke to him on the 2.7.2008 regarding this situation. He took my advice to take a long term view and leave the unit trusts as is'.

[34] Comprising several pages are further hand written notes, undated and headed, 'Meeting With The Bothas,' which supposedly ties in with a meeting with Second respondent in August 2008. The essence thereof is as follows:

34.1. Complainants sold flats which produced income via rental and moved to unit trusts;

[3] Presumably the 2nd respondent

34.2. Complaint that respondents had done nothing about the markets. Complainants are concerned that the portfolio is eroding and they do not believe that the markets will recover;

34.3. Complainant is worried that by drawing an income he will erode the capital base. As such complainant enquires about dropping income to which Second respondent advises that the clients should drop the income from R9 000 to R7 500 per month if they can afford it;

34.4. Second respondent advised that the portfolio is stable and that complainant should not alter it. The global markets are struggling and hence the drop;

34.5. 'Wants to know why it seemed that we did nothing about the markets. He say that they are R300 000 down. He says that the portfolio is eroding and this is worrying;'

34.6. With reference to R250 000, 00, which complainant had in cash, Second respondent suggested that the markets are nicely priced and that they should consider adding to the Stanlib portfolio. 'The client cannot relate to past performance. He wants to know what is happening now not in the past.'

[35] The Stanlib application forms show investment objectives as being long term oriented, with capital growth & income being the primary objective.

[36] The client advice record of the 16th January 2007 shows Guy Coleman as the adviser. The risk profile shows first complainant as a moderate investor with

capital growth and income as the objectives. He answers yes to whether he has an emergency cash fund.

E. THIRD RESPONDENT'S VERSION

[37] Coleman contends that he had no say in the allocation of the portfolios as this was all managed by the Ronald Walsh, the owner of the company. He did not agree with the allocations and this was the reason for resignation in January 2009. He points out that on the disclosure notice the Second respondent was noted as the party accepting the transactions; all clients were the property of the Second respondent.

[38] He states that First respondent was created by the Second respondent on the basis of his research which indicated that over the long term an investment was best suited to equities. This contrasted with what Third respondent had learnt about the necessary diversification of clients' portfolio in certain circumstances.

[39] Third respondent goes on to state that the Second respondent met with the clients personally to re-allocate the clients' portfolio due to the concerns that they had over the market. At that stage the resources sector was the only one providing positive returns and the Second respondent allocated many of his clients solely into resource based funds. He suggested this allocation to the client, informed them that although it would be much more volatile he firmly believed in this approach. Outraged by second respondent's conduct, Third respondent contacted their compliance officers to report these actions and asked them to intervene but to no avail.

F. DETERMINATION

[40] On respondents’ own version complainants were very cautious of the markets but knew that respondents specialised in unit trusts.

[41] This Office points out that prior to the investments complainant had drawn an income from a fixed investments and rental income. There is no indication that complainants were experienced investors with a proper understanding of market fluctuations. On the contrary complainants were cautious and sought out respondent’s advice because of the latter’s specialization in this field.

[42] Complainants’ state that the investment did not need to be guaranteed and they understood that there could be fluctuations, but nothing prepared them for the stress of the volatility which saw their investment almost depleted. They assert that they would never have invested in such aggressive funds if they had known that this would be the case. In short, complainants are saying that they did not understand just what they were getting into. If this were found to be true, it would imply respondents failed to appropriately advise complainants and make appropriate disclosures. A further key component of complainants’ case is what they refer to as the structure of the investment. In this regard, they point out that there was no provision for short or medium term financial needs; in other words no provision for income withdrawal without the deleterious impact on capital as occurred here during the market downturn.

[43] In fact complainants were compelled to cease income withdrawals, exist on their savings and First complainant had to come out of retirement and go back to work.

[44] The FAIS Act in section 8 talks about appropriate advice. In this regard section 8 (1) (a) of the Code requires that the provider take reasonable steps to seek from the client appropriate and available information … to enable the provider to provide the client with appropriate advice. Added to this we have section 8 (1) (c) which requires that the provider identify the financial product or products that will be appropriate to the client's risk profile and financial needs.

[45] Section 3 (1) (a) (iii) requires that the representations to the client be adequate and appropriate in the circumstances when seen against the knowledge of the client and section 7 (1) (c) (xiii) requires that these representations provide full and appropriate information as to any material investment or other risks associated with the product. Section 8 (2) demands that the provider take reasonable steps to ensure that the client understands in order to make an informed decision. The mischief behind the provisions mentioned in the two preceding paragraphs is simple. It is to ensure that clients are provided with appropriate advice and to prevent unpleasant surprises. A risk profiler on its own can never be the sole determiner of a client's risk profile. Appropriate advice demands that relevant and available information be sought by the provider from the client. In order to appreciate how much risk a client can afford to take, reference must necessarily be made to what the client has by way of assets and financial arrangements. To put it in simple terms the client must be in a position to understand what he or she is letting themselves in for.

[46] A simple analysis of the entire record provided to this Office, including the bundles of documents, would support the conclusion that the complainants were not able to make an informed decision. For example, the very first set of minutes of the meeting of the 22 January 2007 talks about a discussion on

corrections in the market and how the long term perspective of an investor causes those corrections to be less of a concern. What complainant needed to know is the fact that he stood to lose a substantial portion of his investment during market downturns but on an upswing, substantially more could be made. It is no wonder that complainants said that had they known what they now know, they would not have agreed to buy the investments. Respondents were specifically asked to provide evidence supporting their disclosure of the investment including disclosures pertaining to risk. See in this regard the notice dated 18 October 2010 in terms of section 27 of the FAIS Act. There is no explanation found in the respondents' evidence of the possible extent of an equity downturn or its impact, particularly whilst drawing an income. It is this drawdown on income from an equity fund that must be approached with circumspection.

[47] Whilst this was not an issue with the initial and somewhat smaller investment in the first quarter of 2007, the position altered in November 2007 with the complainants investing R500 000, 00 each. The implications of which were further magnified with the shift to commodity funds in April and June of 2008. Quite simply there is no advice record as required in terms of section 9 of the Code to explain just why a move to higher risk, single sector commodity funds in the midst of a financial crisis is likely to satisfy the complainants' needs and objectives. Likewise there is no record of advice in respect of the November 2007 investment which would in any way indicate to the complainants the potential risks or the options to moderate such risks, particularly given their income drawdown.

[48] All of this essentially goes to appropriateness of advice as required in section 8 (1) (a) and (c) of the Code. Whilst the complainants were a moderate risk profile, in isolation this does not determine product selection. The Code requires that the adviser seek appropriate and available information to render appropriate advice and identify the products appropriate to the client's risk profile and financial needs. In a nutshell the Code requires an educated decision based on an overview of a client's circumstances.

[49] In this instance complainants were getting on in years, whilst understandably looking for a better income; there is nothing about their financial situation which warranted high risk investments or the taking of unnecessary risks. Additionally, the complainants were cautious by nature and appeared to have had limited investment experience. The mere fact that they agreed to go on with such a risky strategy simply means they were reliant on the respondents for advice. Certainly nothing on file points to the contrary.

[50] That respondents rendered advice to the complainants is accepted in their respective versions. Whilst the Second respondent attempted to justify the advice, Third respondent attempted to divert attention onto the Second respondent.

[51] Neither defence prevails, in that quite simply, they both breached section 2 of the Code in failing to render financial services with the requisite due skill, care and diligence, leading to the complainant sustaining losses in the market downturn.

[52] It is the respondents' actions that occasioned the loss suffered by the complainant.

G. QUANTUM

[53] Having determined that the advice was inappropriate and in violation of Section 2 of the General Code, it is necessary to determine the quantum. In this regard given both that the Investec portion of the portfolio is comparatively small and that a certain element of risk is not necessarily out of line, I determine that it is necessary to exclude this from a calculation of the quantum. This leaves the considerably larger Stanlib portion, in respect whereof Stanlib kindly provided this Office with a breakdown of what the complainant's investment would have been had his portfolio been held in more appropriate portfolios.

[54] In essence these are what if scenarios, or back testing based on complainants having invested in either a money market fund or a moderate fund, in this instance the Stanlib Balanced fund. Both the money market and balanced fund were back tested from the inception of the Stanlib portfolio in November 2007 until 13th December 2011, taking into account the withdrawals at the relevant periods. The relevance of December 2011 is that at this point the markets had recovered to a degree and the complainants' new adviser rebalanced the portfolio. As previously indicated the complainants did not pull out at the lowest point and instead remained invested.

[55] Nevertheless the indicated internal rate of return over the statement period (annualised) on both the First and Second complainants' portfolios as at the 13th December 2011 was a negative -3.44% and -3.32% respectively.

[56] Owing to the fact that both the First and Second complainants' portfolios are essentially identical the back testing on both the money market and balanced

portfolio was conducted on First complainants' portfolio only. To this end both the balanced and money market funds reflected a difference in their favour to the tune of R102 148.54 and R195 303.32 respectively should First complainant have been so invested.

[57] Setting aside the fact that that there was no provision made for an income portion of the complainants' investments and whilst recognising that it is not an exact science it would not have been unreasonable to have allocated the balance of the portfolio to a balanced type fund given complainants circumstances. To now arbitrarily deem a certain portion of the portfolio as having been allocated to the income portion has its difficulties. Accordingly it would be fair and reasonable to continue on the basis of the entire amount having been allocated to the balanced fund.

[58] The amount by which each complainant would have been better off in the balanced fund is R102 148.54. Accordingly it is fair and reasonable to make an award to this effect.

H. ORDER

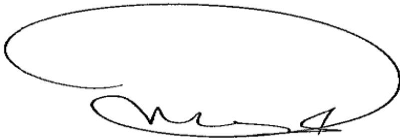
[59] In the premises, the following order is made:

1. The complaint is upheld;

2. Respondents are hereby ordered, jointly and severally, the one paying the other to be absolved, to pay to First and Second complainants equal amounts of R102 148.54 each;

3. Interest at the rate of 9 %, per annum, seven (7) days from date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 5th DAY OF FEBRUARY 2015.



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NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS