IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA **Case Number: FOC 1109/06-07/EC (5)**

In the matter between:

WILLEM JOHANNES DE LANGE First Complainant

ELMA CORNELIA DE LANGE Second Complainant

and

JOHAN STANDER T/A JOHAN STANDER MAKELAARS Respondent

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

A. PARTIES

[1] The First Complainant is Mr Willem Johannes de Lange, an 81 year old pensioner of 92 Santos Haven, HEIDERAND, 6511.

[2] The Second Complainant is Mrs Elma Cornelia de Lange, a 74 year old pensioner of 92 Santos Haven, HEIDERAND, 6511. She is the wife of the first complainant.

[3] The Respondent is Mr Johan Stander ('Stander') conducting business as Johan Stander Makelaars, who on his letterhead dated 20 October 2006 provides no physical address nor his Financial Services Provider ('FSP') licence number. His Postal address is stated to be P O Box 2704, MOSSELBAY, 6500.

[4] A search of the Financial Services Board website where details of registered financial services providers may be accessed lists the following regarding what appears to be several licences held by the respondent:

4.1 FSP No. 11984 Johan Stander trading as Johan Stander Finansiele Advies Diens;

4.2 FSP No. 11985 Dotcom Trading 765 (Pty) Ltd trading as Johan Stander Makelaars;

4.3 FSP No. 11986 Rose-Mare Stander trading as Johan Stander Makelaars; and

4.4 FSP No. 34366 Johan Stander Makelaars (Pty) Ltd.

Whilst the first three entities are stated to be "authorised", the FSP number of the last one has been cancelled and the entity is therefore not allowed to render financial services in terms of the FAIS Act.

[5] Mr Johan Stander responded to the complaint on a letterhead with the name "Johan Stander Makelaars · Brokers" in bold. He signed the letter under the name "Johan Stander (B.A.-Regte) FSB Lisensie nommer: 11984". It is therefore clear that for the purposes of this determination the respondent is Mr Stander in his personal capacity and under the stated FSP licence number 11984.

[6] What is cause for concern is the confusion created by the several FSP licences issued under very similar names. Also, on the letterhead referred to in [5] above and just below the name "Johan Stander Makelaars · Brokers" appears yet another name: "Johan Stander Finansiële Adviesdienste". This is something that the Financial Services board should look into regarding this FSP and any others who may be operating similarly. The rationale for an FSP operating in this manner is not known. As I said, it certainly is a recipe for causing confusion in the minds of the public.

B. THE BACKGROUND

[7] In a letter dated 26 June 2006 the first complainant says Stander was his and his wife's (2nd complainant's) broker. They had a large amount of their cash investments in money market funds. This was apparently a reference to the so-called 'AIMS Offshore Investment Portfolio[s]' of the complainants. The investments consisted of 'Investec USD Money Fund[s]' and 'Investec Euro Money Fund[s]'. Stander had given them advice about a number of alternative investments, which they rejected. They had told him that they would consider

alternative investments only if they could provide a little more ('bietjie meer') income than the money market funds but which are as safe as the latter. As a result, says first complainant, in November, 2004 Stander informed him that Leaderguard Spot Forex ('LSF') was such an investment. Stander, and Christine Immelman of Leaderguard Securities (Pty) Ltd ('LS') - the South African marketing arm of LSF - had recommended investment in LSF so strongly that he and his wife invested in the scheme by withdrawing the AIMS funds and investing them in LSF. LSF was an entity incorporated and registered in Mauritius. LSF and LS have since both been liquidated.

[8] First complainant says further that about a month later, in December, 2004 he read in the press that Leaderguard was "bankrupt" and he could not get his money back, from Stander even though he was promised it. He states he is 78 years old (in 2006) and that he is very concerned about their money and seeks help in recovering it. According to the first complainant the total amount invested by him was €39 420, 62 and that by his wife €34 493, 90. The Rand equivalent at the time, according to complainants, was R308 327, 21 and R270 804, 43 respectively.

[9] Stander furnished a detailed response (which I shall revert to later on in this determination). In essence he says he was authorised in terms of his FSP licence to market Foreign Currency Denominated Investments ("Forex") and more specifically also LSF. He avers that he had complied with all relevant provisions of the General Code of Conduct for Authorised Financial Services Providers ("the Code") framed under the FAIS Act when advising the

complainants. He does not believe he was negligent in advising the complainants to invest in LSF.

The relief sought by Complainants

[10] In a letter dated 28 August 2006 addressed to Stander, the First Complainant tells him that they seek to be compensated for the capital amount together with interest at the rate of 15.5 % per annum from November, 2004 to date of payment. In their complaint to this Office they likewise say they seek a refund of their capital together with interest.

Investigation by this Office

[11] After receipt of the complaint a letter dated 11 August 2006 was addressed to Stander in accordance with the provisions of the Rules of Proceedings of this Office asking him to attempt to resolve the matter with the complainants. The matter could not be resolved.

[12] An e-mail dated 29 September 2006 was sent to Stander in terms of section 27(4) of the FAIS Act requesting a statement from him together with a copy of his file about the matter.

[13] Stander responded with a letter dated 20 October 2006 in which he provided a detailed response to the complaint. What follows is a summary of what apparently are his main contentions. They were provided in Afrikaans and what follows is my translation.

Stander says –

13.1 As intermediary he was licensed by the Financial Services Board (FSB) to give advice on "Foreign currency denominated investments instruments, including a foreign currency deposit" in terms of his FSP licence No. 11984. I shall revert to this later.

13.2 It is clear, he says, that his licence gave approval for him to market forex products and more specifically it approved Leaderguard Spot Forex. This is because in Form FSP 11 information is requested about the clearing firm or foreign forex services providers. Stander mentioned LSF, and that it was registered in Mauritius. Stander says by implication this meant that the FSB had approved LSF as otherwise it would have not licensed him to do business with LSF.

13.3 He was sent an e-mail dated 1 November 2004 by a Rod Lowe ('Lowe') then of LS stating that LS had been "FSB approved" as it had issued Licence No. 17073 to the company. In the e-mail, which was addressed to one Schoeman Botha, he states the following:

> *'Leaderguard Securities Pty Ltd – attains FSB Approval – License No. 17073.*
>
> *Hi there everyone,*
>
> *Fantastic news!!!!*
>
> *Leaderguard Securities (Pty) Ltd – the SA marketing entity for Leaderguard Spot Forex (Mauritius) has been FSB approved.*
>
> ***Our FSB license number is 17073.***

Congratulations to the Directors and Compliance team at Leaderguard for their hardwork (sic) and perseverance – to ***ensure that Leaderguard Securities (Pty) Ltd is the first FSB approved Managed Forex Company in South Africa.***

. . .

Regards

Rod Lowe
B Com (Hons.) CFP
Leaderguard Securities'

13.4 During February 2003 the 4i-Group of which Stander says he was an "associate and director" sent two people to Mauritius to enable them to make an informed decision about LSF. A detailed investigation was carried out – more than would be expected from the financial adviser, he says – to determine the workings ("werking") and products of LSF.

13.5 He also obtained a copy of the licence issued to LSF by the Financial Services Commission of Mauritius.

13.6 International companies with a reputation for integrity and reliability were LSF's business partners. KPMG (Mauritius) was LSF's auditing firm, Saxo Bank and Investec Bank (Mauritius) its bankers and Federal Trust the "custodian" trust company. In discussions with these firms they confirmed that the marketing material was true and correct.

13.7 At the time he recommended the investment to the complainants in November 2004 he had no reason to be suspicious of or concerned about LSF.

13.8 His firm has under management more than R90 000 000, 00 of which the LSF investment comprised only R1 200 000, 00 or less than 1.3% of the total assets under management.

13.9 His recommendation to his clients had always been that foreign investments which were performing poorly should be shifted to LSF, which in any event did not promise excessive returns but rather between 8% and 15% per year.

13.10 Even LSF's regional manager in South Africa, Christene Immelman and Stander's co-director of the 4i-Group, Michael Calitz, had made not insubstantial investments in LSF.

13.11 Complainants together invested about R600 000, 00 in LSF.

13.12 The 80% capital guarantee was better than a money market investment with no guarantee.

13.13 He was not negligent; any fraud or other illegal acts that may have been committed by the directors and/or employees of LSF were outside his control.

The Issues

[14] The issues to be decided are:

14.1 Whether Stander was authorised to market forex products;

14.2 Whether Stander acted in a manner which is not in compliance with the FAIS Act and/or negligently and if so, whether his conduct caused the complainants to suffer damage or financial prejudice; and

14.3 The amount of such damage or financial prejudice.

C. DETERMINATION AND REASONS THEREFORE

Whether Stander was authorised to market forex products

[15] I turn then to the first issue. According to information furnished to this Office by the Financial Services Board, Stander applied to be registered as a Financial services Provider ('FSP') and for authorisation to give advice on Forex on 2 August 2004. He had mentioned in a supporting document (Form FSP 11) to his licence application that the foreign entity he would be dealing with was LSF. He was – like many others – given a blanket exemption to continue giving advice whilst his licence application and Forex authorisation

was being processed. Stander has not been forthright in this respect. In his response[1] to the complaint he says he was licensed to give advice on forex investments. But the rendering of the service to the complainants took place during the period of the exemption, i.e. prior to 21 December 2004. The licence and authorisation were granted only on 21 December 2004 which was long after he had advised complainants during the exemption period. The implications of this will be apparent below. (The fact that LS – the marketing arm in South Africa of LSF – was operating under an exemption whilst its application for a licence was still being considered by the Financial Services Board, has been the subject of critical comment by this Office in its determination in another Leaderguard matter[2].)

Whether Stander acted in a manner which was not in compliance with the FAIS Act and/or negligently

Disclosures

[16] I turn then to the second issue. The crisp question is whether Stander acted with due skill and diligence when he advised complainants to invest in LSF given the complainants' particular circumstances. They were 78 and 72 years old respectively and Stander, as will become apparent later, by his own admission knew they had a conservative risk profile.

[1] Sub-par 13.1 above

[2] *Selwyn Comrie and Another v Ewing Trust company Limited FOC 1807/05/KZN (5)*

[17] The Code *inter alia* provides:

> Section 2: 'A provider must at all times render a financial service honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.'
>
> Section 8(1)(c): 'A provider . . . must, prior to providing a client with advice . . . identify the financial product or products that will be appropriate to the client's risk profile and financial needs . . .'.
>
> Section 8(2): 'The provider must take reasonable steps to ensure that the client understands the advice and that the client is in a position to make an informed decision.'
>
> Section 7(1): Subject to the provisions of this Code, a provider . . . must –
>
> . . .
>
> (c) in particular, at the earliest reasonable opportunity, provide, where applicable, full and appropriate information of the following:
>
> . . .
>
> (xiii) any material investment or other risks associated with the product, including any risk of loss of any capital amount(s) invested due to market fluctuations;'

[18] A provider's duty to:

> 'act with care and skill is implied by law into every brokerage agreement and according to the trial court in Stander v Raubenheimer [OPD, 11 November, 1993, case number 1611/91] it is a naturale of the agreement[3].'

[3] Peter Havenga 'The Law of Insurance Intermediaries' (2001) p 21

[19] Stander failed to mention to complainants that LSF had not been approved by the FSB at the date (11 November 2004) when the investment in LSF was made. He also did not disclose that he himself was operating under an exemption pending the processing of his licence application. Disclosure of these facts was important. Rejection of either Stander's or LS's licence applications would have meant that any monies invested by his clients during the period of exemption would have had to be refunded to them. Failure to mention this meant that the complainants were not placed in a position to make an informed decision.

[20] Stander also relies on the fact that in the FSP 11 form (which was part of his Licence application) he had mentioned LSF as the entity he would be dealing with. He says by implication this meant that the FSB had approved LSF as otherwise it would have not licensed him to do business with LSF. This is disingenuous. He cannot rely on any implied approval of LSF whilst his own licence had not yet been approved. Stander also appears to rely on the e-mail dated 1 November 2004 from Rod Lowe where he (falsely) stated that LS had been granted a licence and thus obtained FSB approval. But that did not entitle him to assume that the FSB had approved LSF. In any event, it eventually transpired that the licence application of LS (which, like Stander, had been operating under an exemption whilst its licence was being processed) was declined on 18 April 2005. In an e-mail dated 26 August 2009, Mr Malimabe of the FSB informed this Office that 'Leaderguard Spot Forex (Mauritius) was never approved and never submitted an application.'

[21] Complainants submitted that Stander had also failed to properly disclose all costs in violation of the provisions of the FAIS Act. First complainant says he asked Stander what the cost of the investment in Leaderguard would be. Stander would not answer except to say it will be deducted along the way ("dat dit langs die pad afgetrek word").

[22] Stander on the other hand, provided this Office with a document titled "Leaderguard Spot Forex" which, he says, was shown to the complainants ("wat aan die kliente voorgelê is") and the contents explained to them. The problem with the document is that it makes no reference at all to the 1.85% per month commission paid by LSF to LS. What it says is that Leaderguard will levy a fee of US $60.00 for every US $100 000, 00 traded. This represents 0.06% per transaction and is the only cost that Leaderguard was charging. The 0.5% broker's fee, it is further stated in the document, is also recovered from the $60, 00 fee.

[23] LSF paid a commission of 1.85% per month to LS on the value of the initial funds invested by clients which was over and above the $60, 00 trading fee. According to a report compiled by the Financial Services Board[4] the various intermediaries and consultants were allegedly unaware of this commission paid by LSF to LS. Stander says he was not aware of this either. Of this 1.85%, 0.5% was payable to the broker and a further 0.5% to the consultant. This is obviously contrary to what Stander says in the document where it is

[4] Financial Services Board: REPORT ON OUR FINDINGS OF THE INSPECTION INTO LEADERGUARD SECURITIES (PTY) LTD AND ASSOCIATED ENTITIES - at par 234

said that the broker's commission was included in the $60, 00 trading fee levied by LSF.

[24] Section 7 (c) (iii) of the Code provides:

> where the financial product is marketed or positioned as an investment or as having an investment component –
>
> (aa) . . .
>
> (bb) separate disclosure of any charges and fees to be levied against the product, including the amount and frequency thereof . . . in such a manner as to enable the client to determine the net investment amount ultimately invested for the benefit of the client."

[25] The commission of 0,5% per month was accepted by complainants as they do not dispute the annualised amount of 6%. But, they were perturbed by the fact (which first complainant found out about only later) that the total cost structure of LS was in fact a much higher 1,85% per month. However, I accept that in all probability Stander did not know of the other 1,35% monthly costs involved as this appears to have been arranged between LS and LSF. Having said that, I am of the view that Stander, or, for that matter any provider has a duty to find out what the total cost structure of an investment product is. It is only by taking <u>all</u> costs into account that one can determine whether they are sustainable or not. Again, the complainants could not have made an informed decision where there was non-disclosure of all the costs.

[26] The total commission deducted from the initial funds invested was an astronomical 22,2% per annum! It made the investment unsustainable.

Appropriateness of advice

[27] The monies invested in LSF were sourced from foreign investments managed by ABSA Investment Management Services (Pty.) Ltd. ('AIMS') for the complainants. These investments were called 'AIMS Offshore Investment Portfolios,' comprising Euros and Dollars. This Office asked AIMS to explain the AIMS Offshore Investment Portfolios. In a letter dated 5 August 2009 it explained, *inter alia,* that the amounts invested (in Euros) by first and second complainants respectively in LSF were €39 411, 43 and €34 484, 96. (The Dollar denominated portion was converted into Euros whereafter the total amount was transferred to LSF.) Stander says the AIMS investments had performed poorly and had caused the complainants some financial loss but did not provide any further details.

[28] Complainants had a further investment of R650 000, 00 with AIMS called 'Global Investment Option IV,' which was a guaranteed tranche. Those investments matured in 2006 and were paid over to the complainants. Nothing further needs to be said about them save that Stander was aware of them and that they fitted in with the complainants' conservative risk profile and in any event, they were guaranteed.

[29] Stander made an analysis of complainants' total investment portfolio (including the LSF investments) and concluded that it consisted of about 52, 47% cash, 29, 41% properties and 18, 13% in shares. The investment in LSF consisted of 12% of the complainants' total asset portfolio, which included their residential property worth R800 000, 00 and about R250 000, 00 worth of shares in so-called "Blue Chip" companies. As I understand Stander's submission, the complainants could therefore be exposed to some high risk investments hence the advice to invest in LSF. This misses the point.

[30] The complainants were 78 and 72 years old respectively at the time the investment in LSF was made. Stander admits to being aware that the complainants had a conservative risk profile. Coupled with that is first complainant's version that he had told Stander he wanted an investment that had a similar risk exposure to that of a money market fund, but with better returns. Stander does not pertinently dispute this but rather, the tenor of his submissions is that he had handled the complainants' portfolio as a conservative one. He says with reference to the investment in AIMS guaranteed tranche that even this confirms that he managed Mr De Lange's portfolio within his conservative risk profile. (*"Ook hierdie bevestig dat ek mnr. De Lange se portefeulje binne sy konserwatiewe risiko profiel bestuur het...."*)

[31] In the letter dated 5 August 2009 AIMS explained that the funds were invested in the "Investec USD Money Fund and . . . into the Investec Euro Money Fund. . . . The Asset allocations of these two offshore funds were <u>interest</u> based funds and were relatively <u>low risk</u> investments (my emphasis)*."*

Therefore, Stander's argument that he had recommended LSF because complainants' then existing off-shore foreign currency denominated investments were not doing well does not make sense. Why, in that case, move them into an investment which was fraught with volatility and was of a high risk nature? There lies Stander's fault.

[32] Although Stander established that complainants were risk averse, i.e. they had a conservative risk profile, he nevertheless recommended investment in high risk forex trading.

[33] The marketing material specifically states -

> 'Although not an underwritten capital guarantee, trading mandates and strict risk management focussed (sic) on conservative growth and the preservation of capital.'

[34] In the presentation that Stander says he made to the complainants with the assistance of Immelman there is a document in which it is stated that

> 'Capital invested has 20% stop-loss protection managed by Leaderguard securities risk management team.'

[35] In his response to the complaint he merely (vaguely) says the various entities such as the Auditing firm confirmed that the marketing material was correct. But this fails to address the issue that he did not understand the product. Complainants had already previously rejected alternative investments suggested by Stander. Had they been aware of the fact that none of the

capital amount was guaranteed by LSF, they would no doubt have declined to make that investment as well given its speculative element and their request to him for an investment similar to a money market fund. Also, As I said earlier, the funds moved to LSF were from a low risk investment.

[36] That Stander then moved the complainants from the AIMS Dollar and Euro Money Market investments to LSF indicates that he completely misunderstood the nature of the LSF product. This is apparent from his statement that the LSF product constituted an 80% guarantee when in fact it was not.[5] He failed or neglected to notice a condition stipulated in the document titled 'The General Terms and Conditions' which provides:

> '3. Pre-determined risk mandates and trading styles may change from time to time according to market conditions. **No capital guarantee is offered by LSF and the investor warrants that he/she shall not hold LSF liable for any capital losses suffered by the investor.'** (My emphasis.)

[37] In the given circumstances, Stander's advice to complainants to invest in LSF was negligent and in breach of his duties as provider in terms of the Code. I am therefore of the view that Stander's inappropriate advice caused complainants their loss. I will revert to this aspect again below.

[38] Stander says complainants fully understood the nature of the investments, in particular, first complainant. However, as stated above, Stander himself did

[5] Sub-par 13.12 above.

not fully understand how the investment worked. How, then, would the complainants have understood the mechanics thereof? He in fact told this Office that his recommendation to his clients had always been that foreign investments which were performing poorly should be shifted to LSF[6].

[39] In the circumstances, Stander's assertion that the 80% capital guarantee was better than a money market investment with no guarantee is unconvincing, to say the least. He ought to have been alert to what is set out in the document titled Foreign Exchange Risk Disclosure Notice:

> '8. Under certain trading conditions it may be difficult or impossible to liquidate a position. This may occur, for example, at times of rapid price movement. Placing a Stop-Loss Order will not necessarily limit your losses to the intended amounts, because market conditions may make it impossible to execute such an Order at the stipulated price.'

[40] The Leaderguard investment ultimately constituted a speculative investment in an aggressive portfolio, i.e. at the opposite end of the spectrum to that of a conservative one. Unlike a younger person who is still employed and can recoup his losses, the complainants could not, in their situation, take the risk they were exposed to.

[6] Sub-par 13.9 above.

Replacement protocol

[41] Further non-compliance with the Code is the fact that there is no replacement advice document on record as required by section 8(1)(d) of the Code. Therefore there is no evidence whether any comparison was made between the replaced product and the replacement product. (Risk, costs, etc. should have been shown in detail for the complainants to make an informed decision). The previous AIMS investments were in Euro and USD money market investments.

[42] Switching money market investments into currency speculation is in my view, negligent and not acceptable if the client had no knowledge of the factual risks involved or if he had a low risk profile, but that depends on the personal circumstances of the person, such as age, value of total assets, and so on. However, there is a huge difference between investing and speculative trading. In any event, the complainants specifically requested something as conservative as or close to the Investec money funds but with slightly better returns.

[43] As an experienced provider of many years Stander surely knew or ought to have known that forex trading is volatile, subject to the vagaries of almost daily fluctuations in value and is inherently a high risk investment. So why did he recommend the LSF investment? I can find no other reason other than his own misunderstanding of the nature of the product and self interest or commission to be earned that caused him to recommend it.

[44] Respondent's actions lead to complainants' loss by advising them to invest in LSF. They should never have been placed there in the first instance. I am of the view that in the circumstances Stander should be held liable for the full loss suffered by the complainants.

Quantum

[45] Complainants stated that the invested amounts in Euros were €39 420, 62 and €34 493, 90 respectively. However, in its two letters dated 5 August 2009, AIMS informed this Office that the amounts were in fact €39 411, 43 for the first complainant and that of second complainant €34 484, 96. I will accept the latter figures as being the correct ones. The differences are marginal.

[46] It is extremely doubtful, after almost four years since LS and LSF were placed in liquidation, that the complainants would recoup any of their capital from those entities. However, if they do then it stands to reason, if the respondent has in the meantime compensated them for their loss that they would have to reimburse the respondent for any amount that would constitute a double payment to them of their capital and interest. It is left to the respondent to enter into an appropriate agreement with the complainants in this regard when settling the claim.

CONCLUSION

[47] The complainants are retired and elderly persons. Capital preservation with reasonable income – in other words a conservative risk investment portfolio –

is what they had in essence. It is not in dispute that the respondent was aware of this. Moving part of their investment capital from a low risk investment to one of high risk was negligent if not reckless and transgressed various provisions of the Act and the Code and complainants suffered losses as a result.

THE ORDER

I make the following order:

1. The complaint is upheld;

2. The Respondent is ordered to pay First Complainant (Euros) €39 411, 43 which amount must be converted into rand value as at the date of payment;

3. The Respondent is ordered to pay Second Complainant (Euros) €34 484, 96 which amount must be converted into rand value as at the date of payment;

4. Interest on the aforesaid amounts at 15.5 per cent per annum calculated from seven days after date of this order to date of payment;

5. The Respondent is to pay the case fee of R1 000, 00 to this Office.

Dated at PRETORIA this 15 day of October 2009.

CHARLES PILLAI

OMBUD FOR FINANCIAL SERVICES PROVIDERS