IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 05860/12-13/ EC 1

In the matter between:-

LEON ERASMUS **1st Complainant**

ANNA CAROLINA ERASMUS **2nd Complainant**

and

MADELEINE ISABEL POTGIETER BROKERS **Respondent**

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

A. INTRODUCTION

[1] Complainants were advised by respondent to invest their savings into Sharemax Investments (Pty) Ltd (Sharemax) on the promise that they would receive monthly interest payments ranging from 11 % to 12,5 % per annum.

[2] Acting on the advice of respondent, complainants invested their funds into Sharemax, more specifically in syndication 15, the Villa Retail Holding Limited.

[3] The investments were effected on or about November 2009 and consisted of two separate payments of R275, 000 and R125, 000, respectively.

[4] Complainants received interest up to and including July 2010. Thereafter all payments suddenly stopped.

[5] First complainant phoned respondent who promised to establish what the position was and let him know.

[6] At that stage there was wide negative media coverage on Sharemax including suggestions that the South African Reserve Bank was conducting an investigation on Sharemax.

[7] In September 2010 Sharemax issued a newsletter informing all investors that income would be reduced as various property syndications under Sharemax were experiencing difficulties in paying out income as agreed[1].

[8] The registrar of banks concluded in 2010, that Sharemax's funding model was in contravention of the Banks Act.

[9] Complainants are of the view that lost their investment. They have asked this office for assistance in recovering their capital from respondent.

[1] Grandstand Newsletter, *Report on Sharemax and the entities under their management*, 22 September 2010

B. PARTIES

[10] First complainant is Mr. Leon Erasmus, an adult male pensioner, whose details are on file in this Office.

[11] Second complainant is Mrs. Anna Caroline Erasmus, an adult female house wife whose details are on file in this Office.

[12] Respondent is Madeleine Isabel Potgieter, an adult female trading as a sole proprietor under the name and style Madeleine Potgieter Brokers whose address is 6 Hanekam Drive, Despatch, 6220. Respondent is an authorised financial services provider with license number 15552.

[13] The regulator's records indicate that respondent was authorised as a financial services provider on 29 September 2004 and the license is still valid. Further, upon perusal of the regulator's records it is apparent that respondent was not licensed to render financial services in relation to product category 1.8 and 1.10 at the time.

[14] At all material times hereto complainants dealt with respondent in purchasing this product.

[15] In this determination, I refer to first and second complainants simply as complainant.

C. COMPLAINT

[16] The essence of the complaint can be surmised as follows:

a) After being retrenched by his then employer during the year 2008, first complainant and his wife, the second complainant, decided to invest the proceeds of his retrenchment pay-out with Absa for a period of one year.

b) The couple, who are married in community of property, were aged 59 and 50 respectively at the time of advice. Their main concern was planning for retirement.

c) Having obtained information from a friend, complainants sought further information about Sharemax from one Mr Fanie du Preez (a Sharemax broker from Port Elizabeth).

d) First complainant later came across respondent's advertisement at his doctor's consulting rooms and owing to the proximity of respondent's offices, contacted her about for investment advice.

e) All three parties subsequently met at complainants' house. At this point respondent gave assurance that the Sharemax investment was safe alluding to the fact that she had even assisted her father in law to invest in the syndication.

f) During that same evening, whilst listening to a radio show wherein Sharemax was the subject of discussion, complainants developed doubts about the investments and telephonically contacted respondent to confirm the veracity of the radio discussions. Complainants were once assured by respondent that their investment would be safe.

g) The following evening respondent arrived with Mr du Preez at complainants' home. Jointly du Preez and respondent assured complainants that their investment was absolutely safe in Sharemax.

h) The investments were eventually placed on or about November 2009, a day after the second meeting, and consisted of two separate payments of R275, 000 and R125, 000 in the name of first and second complainants, respectively.

i) At the time the investment was made, complainants allege that they did not have any other investments in place.

j) In August 2010 the interest payments to the parties ceased. Complainants contacted respondent who in turn provided them with a letter communicating the decrease in income and further assured complainants that the matter would be resolved.

D. RESPONDENT'S VERSION

[17] Prior to setting out respondent's response, it is important that I first outline the details of this Office's correspondence to respondent directing her attention to the complaint.

[18] The complaint was first directed to respondent in terms of Rule 6 (b) of the Rules on Proceedings of this Office (the Rules) on 7 November 2012 with the response due on 20 December 2012.

[19] The correspondence requested that respondent provide, *inter alia*, the following documents:

a) proof that respondent was licensed to sell shares and debentures at the time (licence categories 1.8 and 1.10)

b) copies of complainants' risk profiles; and

c) records of advice including replacement advice records, where applicable;

[20] Respondent did not respond to the aforementioned correspondence.

[21] On 23 June 2015 respondent was notified that the complaint remained unresolved and invited in terms of section 27 (4) of the FAIS Act to furnish this office with her full version.

[22] The notice informed respondent that:

i) she is viewed as a respondent in this matter.

ii) the office shall upon receipt of her response formally commence its investigation procedures.

iii) the office will after investigating the matter make a determination, based on the information in its possession, without further referral to respondent.

[23] The notice further provided the following background to respondent:

(i) 'Property syndications are high risk investments for a number of reasons, let alone the fact that they are structured as unlisted companies; the bases upon which the underlying properties are valued are never fully disclosed.

ii) Being unlisted means that such an investment should be considered as a capital risk investment. Investors such as complainant are at risk as unlisted shares and debentures are not readily marketable, the value, not readily ascertainable, and should the company fail, this may result in the loss of the investor's entire investment.'

[24] Given the background facts set out in paragraph 24 of this determination, respondent was invited to answer the following questions:

a) 'Were your clients properly apprised of these risks? Please provide evidence to this effect. Only information provided to your client at the time of advice will be acceptable. In other words, we are looking for a record of advice, which must have been provided to your clients at the time of rendering the service. NB: A *post facto* account of what was said would not be acceptable.

b) What information did you rely on to conclude that this investment is appropriate to your clients' risk profile and financial needs? In this regard your attention is drawn to the provisions of section 8 and 9 of the General Code. (Note: The record we are looking for must have been compiled at the time of advising your clients. (A post facto account will not be accepted.)

c) We also need a record that shows that you elicited personal information from your clients, including their financial circumstances, to demonstrate that you understood their circumstances prior to advising them. (Be advised that this record must have existed then. (No *post facto* account will be accepted.)'

[25] Although the response was due on 8 July 2015 it was only delivered on 15 July 2015. Instead of addressing the questions relating to compliance with the General Code of Conduct when advising complainants, respondent simply chose to furnish what she considered appropriate, as demonstrated in the following passages:

a) Sharemax was a widely renowned and recognised investment Company that attracted many income seeking investors.

"Their prospectuses complied and signed off professionally audited regularly, they had a website, they were licensed by the FSB, they had SARB implicated approval after SARB intervention and due diligence and through their marketing campaigns and visibility, a well-recognized and acknowledged institution.

b) USSA was professional and fully aware of regulatory and other aspects regarding broker compliance and broker served under the USSA license for category 1.8 (securities) and 1.10 (debentures) purposes.

c) Everything about Sharemax was transparent and they employed a large number of people to assist with operations. A well run and transparent corporate organisation".

[26] According to respondent complainants had prior knowledge of Sharemax and merely asked her to assist.

[27] Respondent further makes reference to a presentation document which was submitted with this response. The presentation according to respondent notes that she had "*made a proposal based on the client's* ***then financial position, their need for income and financial capability*** *at the time.*' (own emphasis).

[28] Respondent further notes that the *"presentation and prospectus of the Villa was left with the client for a long period of time and they were not forced into the product"*

[29] Respondent also maintains that alternatives were offered to the clients *"however the decision was made to invest the amounts in questions".*

[30] Nothing in the respondent's response improved this Office's understanding of how respondent complied with the Code while advising complainants on these investments.

E. DETERMINATION

Justiciability of the complaint

[31] Rule 4(a) provides that a complaint is justiciable if four conditions are met, namely:

(i) the complaint falls within the ambit of the FAIS Act and the Rules;

(ii) the person against whom the complaint lies is subject to the provisions of the FAIS Act;

(iii) the conduct complained of occurred at a time when the Rules were in force; and

(iv) the person against whom the complaint lies has failed to address the complaint satisfactorily within six weeks.

[32] In light of the above it can be concluded that this complaint is justiciable before the Ombud.

Whether the jurisdictional requirements set out in section 27 (4) of the FAIS Act were fulfilled by this office

[33] Respondent, through the notice in terms of section 27 (4), was informed of the complaint and afforded sufficient time to put her case before this office. Respondent was further warned that:-

(i) this office considers her as a respondent;

(ii) she could be held liable;

(iii) the office would determine the complaint without further reference to her.

Accordingly, the jurisdictional grounds as set out in section 27 (4) of the FAIS Act have been met.

[34] The issues for determination therefore are:

(i) Whether respondent in advising complainants violated the FAIS Act and the General Code in any way. The specific question is whether complainants were appropriately advised prior to concluding this investment.

(ii) If it is found that respondent's conduct violated the Act and the General Code, whether such conduct caused the loss now complained of; and

(iii) Quantum

Appropriateness of the advice

[35] Respondent was invited through the notice in terms of section 27 (4) to provide her records of advice to demonstrate just why this investment was considered appropriate in view of her clients' circumstances. Apart from referring to a

presentation and prospectus, no records were furnished depicting her clients' financial situation at the time.

[36] What is known to this office is that at the time the investment was recommended first complainant had been retrenched and was above the age of 55. The funds utilised to effect this investment were part of his severance pay.

[37] The Villa Retail Park Holdings prospectus clearly indicated that the entities involved had never traded prior to the registration of the prospectus and had never made any profit whatsoever. The investment is described in the prospectus as '***an unsecured subordinated interest rate acknowledgment of debt linked to a share'***. (own emphasis) What complainants understood by this is not clear. Respondent has not denied that she advised complainants that the investment was safe.

[38] In her response respondent plainly avoided the questions dealing with compliance with section 8 (1) of the General Code and simply stated that she had advised her clients to invest a lesser amount however, *"they opted in their own accord to invest more'.* Respondent does not provide her record in terms of section 3 (2)[2] of the General Code and further fails to explain why she did not comply with the section.

[39] Section 8 (1) (c) places an obligation on the provider to identify the financial product or products appropriate to the client's risk profile and financial needs. In

[2] Section 3 (2) (a) of the General Code provides that there must be proper procedures in place to record verbal and written communication relating to a financial service rendered. As well as procedures and systems to store and retrieve such records.

responding to how the product was deemed to be in line with her clients' risk profile, respondent maintained that all suitable and reasonable information was obtained from the client and "*recommendation presented to the client, various products prescribed for the purpose and monies invested were drawn willingly by the clients from their bank accounts*".

[40] The documents provided by respondent however, provide no information to show that respondent had elicited relevant and available financial information from her clients in order to appreciate their financial situation, their financial product experience as well as their objectives.

[41] Had respondent complied with the law, she would have realised that her clients had no capacity for the high risk Sharemax investment and could not afford to risk their savings.

[42] As for advising her clients about the risks inherent in this investment, respondent provided no evidence that she had warned her clients that they could lose their capital thereby violating section 7 (1) (a) of the Code.[3] Quite the opposite was conveyed to complainants, which is not denied by respondent.

[43] It seems reasonable to conclude that regardless of what complainants' circumstances warranted, respondent did not concern herself with their needs. As a result and in violation of section 8 (1) respondent committed her clients' funds to the high risk Villa investment.

[3] Section 7 (1) (a) of the General Code provides that a provider must make full an d frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision.

[44] Respondent can still not explain what information she relied on prior to concluding that the Sharemax Villa investment was suitable for her clients' circumstances.

F. DUE DILIGENCE

[45] When responding to the question posed in the notice in terms of section 27 (4) regarding how the income was paid to investors, given that the building in question was still under construction, respondent boldly stated:

"It was made clear that by Sharemax Directors and marketing that Capicol was to pay the interest to the investors and explained the transaction"

[46] It is common cause that The Villa began paying interest to investors whilst being constructed. That respondent failed to deal with this specific question and the fact that she chose to hide behind this vague statement, clearly shows she had not bothered to carry out any due diligence on the investment.

[47] She does not explain how the cash strapped developer, Capicol, had capacity to pay interest at the rate of 14 % per annum if it did not have working capital to build.

[48] She further provides no details of the economic activity from which Capicol generated the supposed interest that was paid to investors.

[49] Respondent is quick to point out that all necessary information which would have assisted complainants in their decision making could be found in the Villa

Prospectus. Clearly, respondent herself could not have read the prospectus. Had she done so, she would have noted that the prospectus proposed to deal with investors' monies in a manner that was not in harmony with the provisions of Government Notice 459, Government Gazette 28690, (the Notice). In terms of the Notice, investors' funds can only be paid out of the attorneys trust account in the event of registration of transfer of the property into the name of the purchaser or repayment to investors in the event of the syndication not proceeding.[4] The very prospectus relied on by respondent provided for disbursement of investors' funds prior to registration of transfer for purposes of lending it to Capicol, which is clearly against the law.

[50] Respondent cannot explain what measures existed in the Sharemax investment to protect investors against director misconduct.

[51] It has not escaped me that respondent despite being invited, failed to provide information pertaining to the due diligence she undertook about the entities involved in this Sharemax investment, prior to recommending it to complainants. This was a violation of section 2 of the General Code.

[52] It is clear from the aforementioned that respondent invited her clients to invest in a scheme she could not understand; which purported to pay investors above average interest rates, against the backdrop of a sluggish economy when bigger financial institutions were struggling to pay upper single digits returns. It was

[4]Annexure A of Notice 459 of 2006, para 2 (b) provides:
Funds shall only be withdrawn from the trust account in the event of registration of transfer of the property into the syndication vehicle; or underwriting by an undisclosed underwriter with details of the underwriter; or repayment to an investor in the event of the syndication not proceeding.

respondent's duty to carefully analyse the Sharemax business model and not allow herself to be blindsided by empty statements, such as set out in paragraph 45 of this determination. Respondent was out of her depth.

[53] Respondent claims to have operated under the license of the defunct FSP Network (Pty) Ltd, trading as Unlisted Securities South Africa, (USSA).

[54] This does not assist respondent as she cannot be exonerated from carrying out her duties in terms of section 8 (1). The latter was confirmed by the Board of Appeal in Black v Moore[5] wherein it was stated that a "*representative" in effect executes the same acts as are expected from the provider when operating alone. The only exception was said to be: "when a representative either:*

1. *Acts on behalf of the provider;*
2. *Subject to the provider concerned taking responsibility for these acts'.*

[55] In short the Board of Appeal made it clear in Black v Moore[6] that a provider cannot escape liability on the basis as suggested by respondent. In any event, this office received no proof that respondent was indeed a representative of USSA.

G. CAUSATION

[56] Had the respondent followed the law and conducted due diligence on Sharemax she would have understood that the investment was unsafe and posed a risk that her clients had no capacity to tolerate at their advanced age. She would have

[5] John Alexander Moore/ Johnsure Investments CC v Gerald Edward Black, Case number: FAIS 0110-10/11 WC 1, Appeal Board of the Financial Services Board

[6] supra

also realised that the investment was not suitable to the complainants' needs as there were insufficient safeguards against director misconduct or mismanagement.

[57] The test here is not whether or not a collapse, for whatever reason, was foreseeable, but whether or not the investment was appropriate for the complainants, bearing in mind their personal circumstances and tolerance for risk.

[58] It is apparent from respondent's version that she had no idea just what the investment was about. She could not appreciate that complainants were lending money to an entity, which entity would in turn lend the funds to another within their confusing structure, and later to a developer, leaving the complainant with no form of security whatsoever. The very company that would eventually own the property was a private company, separate and distinct to the original debtor.

[59] It is this lack of appreciation of the complicated structure of the property syndications that led to respondent to recommend Sharemax to the complainants, and as a result of such inappropriate advice complainants suffered financial loss.

H. QUANTUM

[60] Complainants invested R 400 000.00 in Sharemax.

Accordingly, an order will be made that respondent pay to the amount of R 400 000.00 plus interest**.**

I. FINDINGS

[61] Based on the facts before me I make the following findings:

[62] In advising complainants to invest their savings into Sharemax without first identifying the financial product or products that will be appropriate to the complainants' risk profile and financial needs, respondent contravened Section 8 (1) (a), (b) and (c) of Part VII of the General Code of Conduct.

[63] Respondent had no appreciation of the risk involved in Sharemax at the time, thus she could not match her clients' risk profile to the product.

[64] Respondent failed to conduct due diligence on the Sharemax investment thereby violating section 2 of the Code.

[65] In further violation of their duty as set out in section 2, respondent was not candid with complainants, in that she failed to disclose her limitations in terms of appreciating the risk involved in Sharemax.

[66] Respondent further failed to maintain a record of advice reflecting the basis on which the advice was given, thereby contravening Section 9 (1) (a) (c) of the Part VII of the Code.

[67] Respondent failed to render financial service honestly, fairly with due skill, care and diligence and in the interests of client and integrity of the financial services industry thereby contravening Section 2 of Part II of the General Code of Conduct.

[68] In the light of the foregoing respondent's conduct resulted in the complaints' financial loss.

J. ORDER

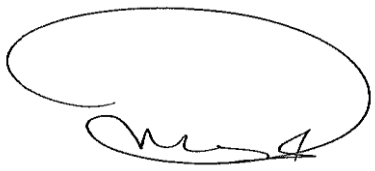
[69] In the premises, the following order is made:

1. The complaint is upheld;

2. Respondent is hereby ordered to pay first and second complainants the amounts of R275 000 and R125 000 respectively.

3. Interest at a rate of 10,25 %, from a date seven (7) days from date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 15th DAY OF JUNE 2016.



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