IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

HELD IN PRETORIA **CASE NO: FOC 2759/06-07 KZN (1) A**

In the matter between:

ADOLF JACOBUS HARE **1ST COMPLAINANT**
CHRISTINA ELIZABETH HARE **2ND COMPLAINANT**

and

ANDRE VAN DER MERWE **RESPONDENT**

DETERMINATION IN TERMS OF SECTION 28(1) (a) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT 37 OF 2002 ("FAIS Act")

A. INTRODUCTION AND BACKGROUND

[1] This case revolves around investments made by complainants in an entity known generally as the GAREK scheme. There have been many other investors who invested in this scheme. They have lost millions of rand in the process. This Office is seized with a number of complaints relating to financial services rendered in the course of recommending investments in the GAREK scheme.

[2] There will be other determinations that will be made in the course of

time on these various cases. This is the first of such determinations.

[3] In order to properly understand the background to this and the other cases that this Office will pronounce upon it is important, as a first step that the nature of the scheme is set out. I shall in the course of this determination refer to the scheme as the GAREK scheme. However, it must be mentioned that the company GAREK is one the several companies which are interrelated in this scheme.

[4] Complaints and enquiries relating to the GAREK scheme were steadily coming into the Office since late 2006. In order to properly understand what the scheme was all about, it became necessary to await a report that the former Minister of Trade and Industry had commissioned against the scheme. This report was only finalised in May 2009 (The DTI Report) and it is now possible to publish the details of the various findings into the GAREK scheme. The findings are material to this and the other determinations that will follow.

The DTI Report

[5] The full report can be accessed at http://www.cipro.co.za/reports/GarekReportExecutiveSummary.pdf. Below is a synopsis of the mandate and the main findings of the report.

[6] Essentially the GAREK scheme involved the formation of various

companies which solicited investments from members of the public through the sale of unlisted shares. These shares were sold on the promise that they would increase substantially in value upon the listing of the entity in which the shares were sold on the Johannesburg Securities Exchange South Africa (JSE).

[7] The unlisted shares purchased by complainants were essentially in two connected entities namely Global Africa Resource and Energy Corporation Limited ('GAREK') and Mwamko Africa Trade Resource Industrial and Commerce Corporation Limited ('MATRIC').

[8] Intrinsically related to GAREK and MATRIC are several other unlisted companies amongst which we have Resourcefin Strategies International Limited ('RSI'); Independent Holdings Limited ('IHL'); Appropriate Structures in Emerging ('ASEM'); and Markets Limited and Holistic Resources Limited ('HRL').

[9] The mandate of the inspectors of the DTI, was to ascertain whether;

> 'The business of any of the companies is being conducted with intent to defraud their creditors or the creditors of any other person or otherwise for a fraudulent or an unlawful purpose or in a manner oppressive or unfairly prejudicial or unjust or inequitable to any part of their members or that any of the companies were formed for any fraudulent or unlawful purpose....'

[10] The investigation found *inter alia* that:

10.1 Shares issued to related entities were done without any proceeds being received, whilst shares issued to public investors were sold at a substantial premium;

10.2 In most instances no determinable value could be found in any underlying assets, to justify these inflated premiums. In fact some of the entities were in the process of being liquidated, thereby resulting in losses for the investors;

10.3 Supposed profits realised by a particular company on the sale of the unlisted shares were transferred to a different company, within the GAREK scheme, to the one selling the assets;

10.4 Assets were randomly transferred from one entity to the other without any substantive or legal basis for doing so and without any resolutions or agreements detailing such transfers;

10.5 Upon transfer of assets from one company to the other, shareholders in the former company were issued with shares in the company to which such assets were transferred;

10.6 Substantial amounts in commission was paid on shares purchased by the individual investors, thereby reducing the value of their investments;

10.7 In addition to a failure in many instances to issue financial statements there have been various additional offences in term of the Companies Act, 1973 (Act No 61 of 1973) (the Companies Act). These included a 'Failure by directors and the company secretary to adhere to corporate governance principles' and a 'failure to hold annual general meetings as contemplated in section 179 of the Companies Act';

10.8 Shares were issued to related companies, within the GAREK scheme, without proceeds being received for such shares. This amounted to financial assistance as envisaged in section 38 of the Companies Act;

10.9 The directors of the following companies within the GAREK scheme failed issues financial statements in contravention of Section 286 of the Companies Act:

10.9.1 RSI issued no financial statements for the years ending 30 September 2000; 2001; 2003 and 2004;

10.9.2 MATRIC issued no financial statements for either the year ending 30 September 2003 or September 2004;

10.9.3 GAREK issued no financial statements for the year ending 30 June 2005.

10.10 ‘Despite commitments to list on the JSE, which was the basis on which investors were invited to invest, the companies have still not listed’. GAREK in particular has not applied for a listing despite making ‘several representations to its shareholders through the company’s website and brokers that the company was going to list on a recognised exchange’;

10.11 ‘According to the company “since 2005 GAREK has been subject to the DTI investigation. The listing of GAREK in any form has been suspended pending a satisfactory outcome of the investigation”. The inspectors fail to see how the investigation could have hampered the listing process as the companies intention to list was initiated in RSI during 1999 as confirmed by four RSI shareholders’;

10.12 ‘A large portion of investor’s funds was not applied to acquire assets and/or investments as was represented to them, but for operational expenses, commission, and as payments to directors and other key individuals associated with the companies’;

10.13 The total funds received by RSI, MATRIC, GAREK, ASEM and IHL amounted to R179,176,382.57 of which R74,046,875.99 was recorded as having been received from investors and an amount of R76,410,739.74 relating to inter- company deposits;

10.14 Total payments amounted to R178,897,640.88 of which R23,753,561.96 was paid to the directors, and R61,597,867.95 paid to other identifiable individuals and entities;

10.15 Of the bank accounts made available for inspection 'only R299,061.89 was left';

10.16 A significant amount, in excess of R10 million, of investor's money was used to fund commission in respect of [the same] shares purchased. Of this amount, respondent appears to have benefitted to the tune of almost R4, 5 million by way of commission for the sale of shares to the public.

[11] The report concludes with the following recommendation:

> 'It is further recommended by the inspectors that the Minister release the report for consideration of possible criminal prosecution of directors and officers of RSI, MATRIC and GAREK and possible recovery of investor's funds by the National Prosecuting Authority.'

[12] Against the background set out above, I turn to the facts of this case.

B. THE PARTIES

[13] The 1st complainant is Mr Adolf Jacobus Hare, an adult male engineer residing at 37 Piet-My-Vrou Street, Monument Park, Pretoria.

[14] The 2nd complainant is Mrs Christina Elizabeth Hare, an adult female teacher married to 1st complainant under ante-nuptial contract, and residing at 37 Piet-My-Vrou Street, Monument Park, Pretoria.

[15] The respondent is Mr Andre van der Merwe an authorised financial services provider carrying on business at 12 Mc Iverstraat, Uvongo, Kwa-Zulu Natal.

C. THE COMPLAINT

[16] During December 2004, complainants were invited to attend a presentation by respondent. This presentation is described by respondent as a 'typical presentation' – one made to all interested investors. Complainants knew the respondent as he was 2nd complainant's mother's financial adviser.

[17] Complainants were introduced to MATRIC, and were provided information by respondent on the company and its prospects. They were advised that an imminent listing in three countries was on the cards. Upon listing, shares purchased by complainants for R2.50 were projected to reach R20.00.

[18] This return was compounded by the fact that the structure of the investment was such that they automatically received two shares in GAREK for every MATRIC share purchased.

[19] Respondent promoted the company in glowing terms and made much of the fact that he himself had invested in excess of R1 million in MATRIC shares.

[20] The assets of the company were reportedly substantial amounting to some R5, 4 billion. Complainants were shown an article in the Time magazine which painted the company in a very positive light; supportive of respondent's claims as to the soundness of the investment. In reality this article was merely promotional material placed on a limited number of copies of TIME magazine. The information contained therein was neither endorsed nor verified by TIME magazine. In short it was an advertorial taken out by GAREK itself.

[21] Respondent pointed out an impressive list of company directors, amongst them, the former president of Botswana, Sir Ketumile Masire.

[22] No interview was conducted to assess 'whether this investment is conducive to our future financial requirements or our present financial position.'

[23] 'The challenges that lay ahead for MATRIC/GAREK and the risks associated with the investment were never mentioned or discussed'.

[24] Respondent advised complainants that the opportunity apparently

expired at the end of December 2004 and as such the complainants were encouraged to ‘act expeditiously.’

[25] As such and acting on the advice of respondent the investment was made, and the application forms completed on 30 December 2004 at which point 1st complainant invested R30,000.00 and 2nd complainant R10,000.00.

[26] After this expiry date respondent contacted complainants and advised that as they were existing shareholders they had the opportunity to purchase additional shares at the same ‘good’ price. They were advised to take up this opportunity because of the excellent returns that could be expected on this investment. Complainants did not take up this additional offer.

[27] The promised listing and several future listing dates never materialised. Various reasons were advanced for the delay, several of which supposedly offered increased shareholder value. In addition various company annual financial statements were not issued.

[28] Complainants state ‘we were clearly misinformed, offered poor advice and the communication was less than adequate’.

[29] To date almost five years later no listing has taken place.

[30] Complainants have requested a return of the money that they have invested. They have also requested that this Office 'engage this broker so that he realizes that he has a responsibility towards his clients and not only towards the company whose shares he is marketing and selling.'

D. THE RESPONSE

[31] As the complaint could not be resolved between the parties, it proceeded to investigation at which point respondent was requested to provide copies of his '**entire file of papers**'.

[32] Respondent was also required to submit a reply to the allegations, taking into account the requirements of the FAIS Act. In particular respondent was required to :

32.1 Provide a statement on how the investment was entered into with supporting documentation, if available;

32.2 The exact commission earned; and

32.3 Specific details as to the source of the investments and the contact details of the individuals or entity that provided the investment.

[33] Respondent was also advised that the DTI Report was being

considered as part of the investigation into this complaint. Respondent was therefore requested to provide this Office with any comments which he might wish to make in respect of the report itself.

[34] In particular his attention was drawn to two issues. They are:

34.1 Firstly, whether respondent had conducted an appropriate due diligence into GAREK; and

34.2 Secondly, as the report stated that respondent had received commission of R4,470,558.92 from GAREK and related companies, of which R3,479,008.92 has been received from ASEM, he was requested to provide copies of documentary disclosures to clients showing that he had had received more than 30% in commission from any particular product supplier.

[35] The figures outlined in paragraph 34.2 above, made it likely that Section 4 (1) (d) (ii) of the General Code of Conduct For Authorised Financial Services Providers and Representatives (Board Notice 80 of 2003) (the Code) may have been contravened.

[36] In particular this requires that if a provider ‘during the preceding 12 month period received more than 30 per cent of total remuneration, including commission, from the product supplier’ this must be disclosed to the client.

[37] Whilst no response was received to the specific queries set out in paragraph 34.2, respondent in a written reply dated 28 March 2007, responded to the complaint.

[38] In his response, respondent annexed, what he described as the transcription of a 'typical presentation' to clients. This 'typical presentation' deals with the origins of, and interwoven share transactions of GAREK. The essence thereof is set out below:

38.1 The initial company was RSI, a company which started in 1998. This controlled 'physical and intellectual properties in Southern Africa, West and East Africa, New Zealand and part of the former USSR';

38.2 RSI later amalgamated with Mamko African Investments ('MAI') and later with ASEM. ASEM was the sponsoring broker when RSI sold 90 million shares to the public between 1999 and 2001.

38.3 As one of its interests 'RSI had a 70% interest in the investment centre of Botswana', a company 'formed and chaired by the former president of Botswana, Sekwet Mashere' (sic). As Mr Mashere wished to become involved with the companies, a new entity MATRIC was established in order to facilitate this;

38.4 The amalgamation between RSI and ASEM came about

because of ASEM's desire to become involved with MATRIC given that 'Sekwat Mashere' (sic) was to be chairman of this new entity;

38.5 With what RSI, MAI and ASEM brought into the new entity it meant that MATRIC was according to a prospectus, valued at R7, 5 billion. This comprised of 1 billion shares at R7.50 per share. (Respondent was requested to provide a copy of this prospectus but to date, none was received);

38.6 As MATRIC had assets both locally and abroad it became too big and a decision was made to split it into two entities. MATRIC kept its name for the African continent and the other company then formed was GAREK for the global assets. The effect of this split was that investors with 3 MATRIC shares were entitled to 3 GAREK shares;

38.7 The professional advisers to MATRIC and GAREK then advised that it would be better to make MATRIC a subsidiary company of GAREK and to keep GAREK as the global company. GAREK was the company then to list on the JSE. MATRIC became a fully owned subsidiary of GAREK. No shares have ever been sold by GAREK and investors have only been allocated shares in consequence of their earlier holdings in RSI, MAI and then MATRIC;

38.8 Now as IHL was a shareholder in RSI, the manner in which the amalgamation was structured meant that for each share that IHL had in RSI they held an option to purchase an additional share at a preferential rate in MATRIC. These MATRIC options eventually converted into two GAREK shares.

38.9 This is the option that complainants purchased from IHL.

[39] In so far as commission was concerned, respondent contended that each complainant received full value of their respective application in shares and that no deductions whatsoever were made. The commission was paid by IHL as the owner of the shares in a private arrangement with respondent.

[40] Explaining the delays in listing GAREK, respondent claimed that in addition to the dates being 'expected and/or proposed dates the reasons were, *inter alia* 'changes in legislation', 'political conditions in West Africa' and 'the Department of Trade & Industry's investigation into GAREK and other companies.'

[41] In so far as the risks of the investment are concerned respondent states; 'the complainants were categorically and specifically informed of the high risk coupled to unlisted shares'.

D. THE DETERMINATION

[42] The following are the issues to be determined:

42.1 Whether the respondent rendered the financial service herein negligently and/ or in a manner which is not compliant with the FAIS Act;

42.2 If it is found that the respondent did render the financial service negligently/ and or failed to comply with the FAIS Act, whether such failure caused the complainant's loss; and

42.3 The quantum of damages.

Whether the respondent rendered the financial service herein negligently or in a manner not in compliance with the FAIS Act

i. The maintenance of proper documentation, including a record of the advice given and disclosures made to complainants

[43] As previously mentioned respondent was required to provide a copy of his entire file of papers. In this regard the only documents provided by respondent were a one-page document each headed 'APPLICATION FORM' and 'MANDATE FORM' respectively. Other documents provided were deposit slips and/or bank printouts, accompanied in some instances by correspondence from complainants to respondent

advising of deposits.

[44] As will become clear no document evidencing any form of compliance with the FAIS Act was provided.

[45] In fact to do justice to the many and varied contraventions of the FAIS Act and the Code would be voluminous. As such, and in the interests of brevity, I shall confine myself in this determination to some of the more pertinent breaches.

[46] I turn firstly to the record of 'verbal and written communications relating to the financial service rendered' as required by Section 3 (2) (a) (i) of the Code. This section states that:

> 'a provider must have appropriate procedures and systems in place to record such verbal and written communications relating to a financial service rendered to a client ..'

[47] Quite simply this relates to the communication between a specific client and the adviser. In this regard, what respondent would have us accept is what he terms a transcript of a typical presentation. Clearly not only does this contravene the Code but this transcript was reconstructed in response to the complaint more than a year after the sale. It could therefore hardly be a true reflection of the communication between the parties at the time the financial service was rendered.

[48] The Application form and the Mandate themselves provide nothing that could be construed as providing a record of what took place. On the contrary, these documents are themselves confusing.

[49] From what I have already said in preceding paragraphs it will come as no surprise to learn that that there is also no record of advice as required by section 9 of the Code. This requires:

> ‘(a) a brief summary of the information and material on which the advice is based;
> (b) the financial products which were considered; and
> (c) the financial product or products recommended with an explanation of why the product or products selected, is or are likely to satisfy the client’s identified needs and objectives’

[50] Of course a record of advice would imply that the respondent had complied with Section 8 of the Code and as such performed a needs analysis; an omission which I deal with in paragraph 102 – 105 below.

[51] It goes without saying that when rendering a financial service, any actual or perceived conflict of interest, requires full disclosure in order that client’s make an informed decision.

[52] Specifically Section 3 (1) (b) of the Code requires that:

> ‘the provider must disclose to the client the existence of any personal

interest in the relevant service, or of any circumstance which gives rise to an actual or potential conflict of interest in relation to such service'.

[53] In a letter addressed to GAREK/MATRIC shareholders and dated 25 February 2005 respondent describes himself as being part of the 'marketing team of GAREK.' This simple statement is perhaps the first real revelation as to the true relationship between respondent and the GAREK scheme.

[54] The true extent of this relationship becomes evident in the DTI Report which reflects that commission of R4, 470,558.92 was paid to respondent.

[55] The DTI Report goes further and describes respondent as one of the 'key individuals' involved with GAREK. The whole tone of the letter dated 25 February 2005 accords with this. In fact were it not for the fact that this statement is contained in respondent's letterhead, one would have no doubt that this was a GAREK/MATRIC statement. As an example in this incestuous relationship that respondent had with the product provider, one need only look at the last paragraph of the letter where respondent states:

> 'I invite everybody to visit our website at www.garek.co.za for further information.'

[56] In essence respondent acted as a *de facto* agent of GAREK. This was not disclosed to complainants and clearly respondent's advice, in the circumstances would have been tainted.

[57] Section 4 (1) (d) (ii) of the Code requires respondent to disclose whether he had:

> 'during the preceding 12 month period received more than 30% of total remuneration, including commission from the product supplier.'

[58] Taking into consideration the amounts paid and the inception dates of the various entities, respondent undoubtedly received more than 30% of his commission from one product supplier in the year in which the shares were sold to complainants.

[59] In truth the various entities are really just differently named versions of the same entity particularly when one considers their interlocking shareholding and commonality of boards of directors. In essence commission from any one of the separate companies was commission from the group as a whole. All that happened is another instance of hiding behind the corporate veil.

[60] In communication from this Office to respondent reference was made to the commission amounts in the DTI report. Respondent was requested to advise whether any declaration was made to

complainants that he had received more than 30% of total commission from any particular product supplier.

[61] Respondent did not reply to this request and as such I must conclude that once again he has failed in his responsibilities toward complainants.

ii. <u>Whether the nature and risk structure of the investment was properly explained and understood by complainants.</u>

[62] In addition to the present matter, this Office has fourteen other complaints detailing similar allegations against respondent. It is notable that in every complaint the allegations are similar. I cannot help but take notice thereof.

62.1 Essentially complainants were advised about an excellent investment opportunity that would only be open for a limited period due to an imminent listing of the company; at which point their shares would increase substantially in value.

62.2 As such it was imperative that they invested at the earliest possible opportunity.

62.3 The assets of the company were in one instance described as ‘mind boggling’ by respondent and in another instance valued at

R5, 4 billion.

62.4 No attempt was made to comply with the FAIS Act and as such no consideration was ever given as to whether the investment actually suited complainant's needs.

62.5 The fact that respondent himself had supposedly invested in the scheme served to assure investors of the safety and security of the scheme.

62.6 The risks inherent in the scheme were never mentioned.

[63] Of course, as in this case, respondent contends that '*the complainants were categorically and specifically informed of the high risk coupled to unlisted share'* and in respondents 'typical presentation' to clients he states *'these are Capital Growth Shares in an unlisted company thus a high risk. However with high risk comes high returns'.*

[64] Given that there is no written documentation supporting respondents claims, respondent relies on the 'typical presentation' as evidence that he explained the risks inherent in the product.

[65] Section 7 (1) (c) (xiii) of the Code requires disclosure of appropriate information of 'any material investment or other risks associated with the product.' Clearly this information would need to be set out explicitly

in any documentation or client advice record. No such documentation exists.

[66] The alleged 'typical presentation' transcript which respondent tenders in support of his contention that the risks were disclosed was made long after the actual sale.

[67] In respondent's letter to complainants dated 25 February 2005, not long after the shares were sold to complainants, no mention is made of the risks involved in investing in GAREK/MATRIC.

[68] On the contrary respondent states that '*the company have* (sic) *achieved outstanding results, and large development has taken place in the structure.'* In fact respondent goes on to entice his clients into purchasing more shares with the statement:

> *'In addition to the issue of GAREK shares in place of MATRIC shares, shareholders still have the "option" to aquire* (sic) *a further GAREK share at a discounted price of R2,50 per share up to one week prior to listing, and R5,00 per share up to 9 months after listing...* ***I encourage shareholders that are financially in the position to do so, to exercise their options and benefit personally from the discount.'*** (my emphasis)

[69] Now either respondent does not believe that there any risks involved in investing in the companies or he is deliberately misleading his clients to

induce them to purchase more shares. Not only has the company done anything but achieve outstanding results but the so called 'discounted price' is a fallacy when one reads in the DTI report that these same shares were sold to related companies for a mere pittance.

[70] The overwhelming evidence leads me to the inescapable conclusion that the risks were not disclosed.

[71] I turn now to the question as to whether the nature of the investment was explained to and was understood by complainants.

[72] Section 3 (1) (a) (iii) of the Code requires that representations must:

> 'be adequate and appropriate in the circumstances of the particular financial service, taking into account the factually established or reasonably assumed level of knowledge of the client;'

[73] Section 3 (1) (a) (iii) must be read with section 7(1) (a) of the Code which requires that a provider must:

> 'provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision'

[74] It becomes clear that respondent himself, is firstly required to have a

proper understanding of the product which he is marketing, and then to convey this to complainants in such a manner that they grasp the issues so as to enable them to make an informed decision. It is for this reason that the legislature has seen it fit to add the provision that the provider must take 'into account the factually established or reasonably assumed level of knowledge of the client'.

[75] I have already mentioned that respondent essentially provided only two documents in respect of each complainant namely the Application form and the Mandate.

[76] In so far as the promotional material placed in the Time magazine is concerned, this by its very nature contains nothing of any substance and could not in any way be construed as contributing to an appropriate understanding of the investment that complainants were entering into.

[77] I turn now to a phrase in the Mandate form which reads as follows:

> 'I IHL hereby sell 4000 of my 'A' option shares to the third Party listed below (the third party being the name of the complainant). I will receive a surplus of NIL paid to me per share. R2.50 of the 'A' option will be paid to MATRIC'

[78] Not only is this phrase at first glance quite confusing, but even after

careful consideration I am no more enlightened as to what it seeks to convey.

[79] In fact a number of questions immediately arise. There is no indication as to what shares are being sold here; they are referred to as 'A' option shares but we are none the wiser if they are IHL or MATRIC shares. Whilst the document clearly indicates that it is IHL that is selling the shares, it is to the say the least surprising that the amount is to be paid to MATRIC and not IHL, the seller.

[80] The Application form in fact compounds the confusion. It is headed:

'**APPLICATION FORM**

MWAMKO AFRIKA TRADE, RESOURCE, INDUSTRIAL & COMMERCE CORPORATION LTD'

and goes on to state:

> 'I/We hereby exercise 12 000 of my /our MATRIC options at 250 (Two Hundred and Fifty Cents) per option'.

[81] Other than the fact that these appear to be what I can consider options on options nowhere on either of these forms is there any indication of what complainants are actually buying.

[82] Supposedly from respondent's typical presentation paragraph 38 we are led to believe that complainants purchased options which IHL held

in MATRIC, which MATRIC shares were then converted to GAREK shares.

[83] It stands to reason that the requirements as set out in paragraphs 72-74 must be evident either from the client advice record and/or additional documentation provided to complainants. Respondents 'typical presentation' even if I were to assume that it is an accurate record of the presentation is anything but easy to comprehend.

[84] The various derivations and related shareholdings of GAREK are confusing and it would be fair to say that without the benefit of the DTI report and time to peruse these transactions carefully it would be impossible to grasp this questionable structure.

[85] Regrettably complainants did not have the luxury of any due diligence reports or appropriate advice before they entered into these transactions. Instead it was a rushed process that had a so-called limited offer period of less than a month. They were encouraged to act quickly given the promised imminent listing.

[86] Not surprisingly they were the approached later to purchase more shares at the same 'good price' given that they were existing shareholders.

[87] The requirement that complainants be able to make an 'informed

decision' must be interpreted to include an understanding of the financial merits of the investment itself.

[88] The DTI report clearly exposes this investment for what it is. It is clear that the options sold to complainant are worthless. The company has no ascertainable assets and investors funds have been used to fund commissions and director's remuneration.

[89] Respondent clearly either did not possess the necessary skill and as such failed to exercise the required due diligence to ensure that he actually understood what he was dealing with.

[90] A far more likely scenario though is that respondent intentionally misled complainants into believing that they were investing in a 'sure thing.'

[91] *Ipso facto* there was no way in which complainants could possibly have been provided with the appropriate information to enable them to make an informed decision.

iii. <u>Whether or not the advice fee was properly disclosed to complainants</u>

[92] Section 3 (1) (a) (vii) of the Code requires that:

> 'all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein and payable to the product supplier or provider be reflected in specific monetary terms'.

[93] Quite simply if a provider receives any form of commission from whatever source, in respect of the sale of a product this must be disclosed. Respondent did not provide this information to complainants as required by the Code. Pertinently when requested to do so by this Office, this is what respondent's attorney states:

> 'Each applicant/complainant received **full value** (respondents emphasis) of their respective application in shares; No deductions were made whatsoever and Commission was paid by IHL (owner of the shares) in a private agreement between the Client (respondents attorney referring to his client, the respondent) and IHL.'

[94] This is nothing short of a deliberate attempt to mislead this Office. Not only did respondent receive commission which he has failed to disclose but the true extent to which he had benefitted from his arrangement with GAREK only became evident upon the release of the DTI Report. Respondent has not disputed the DTI Report.

[95] It is little wonder that respondent is reluctant to disclose such large commission amounts. Complainants in no way received full value for their shares. The shares were acquired by IHL at a mere pittance, if anything, and the DTI Report clearly indicates that the company has no assets of any substance. Income was used to fund directors, related parties and of course commission.

[96] The DTI report makes it clear that the payment of commission in fact

reduced company assets with a corresponding impact on the real value of the share price.

[97] Respondent in failing to disclose this commission has clearly violated the FAIS Act and the Code.

iv. <u>Whether respondent was licensed to sell shares</u>

[98] Respondent is an authorised financial services provider. However, he is restricted to certain financial products. In correspondence with this Office Mr Manasse Malimabe, the head of Enforcement, Financial Advisory and Intermediary Services at the Financial Services Board has confirmed that respondent was, at all material times, not licensed to sell shares.

[99] Respondent's licence was only amended in 2007 so as to enable him to sell shares.

[100] Section 7(1) of the FAIS Act requires that a person not act or offer to act as a financial services provider unless such person has been issued with a licence under Section 8. It goes without saying that such licence must relate to the particular financial product or products that the person is authorised to offer advice and/or intermediary services on.

[101] Section 36 of the FAIS Act makes a failure to comply with Section 7 (1) an offence. Respondent is clearly in contravention of the aforementioned sections and as such was not authorised to sell the shares to complainants.

v. <u>Whether a needs analysis was conducted to ascertain whether the investment was appropriate to complainants circumstances</u>

[102] Section 8 (1) (a) of the Code requires that a provider must:

> 'take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives'

and paragraph (c) of the same section goes on to require that the provider must after conducting an analysis of the information provided by the client:

> 'identify the financial product or products that will be appropriate to the client's risk profile and financial needs.'

[103] Complainants contend that no such needs analysis or risk profile was ever conducted; a statement that was neither disputed by respondent nor ever remotely supported by relevant documentation.

[104] On respondent's own version the shares were sold on the basis of a

'typical presentation' and no account was taken of the suitability or otherwise of this product to complainant's needs.

[105] Unlisted shares are at the best of times a high risk investment, suitable only to seasoned investors with a full appreciation of the facts.

vi. <u>Whether respondent exercised the necessary skill care and diligence to ensure the soundness of the investment itself</u>

[106] The general duty of a provider is summed up in section 2 of the Code which requires that:

> 'A provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry'

This is the very antithesis of the manner in which respondent has conducted himself. For reasons that will become clear shortly I am convinced that respondent either failed to exercise the necessary due skill care or diligence; alternatively was complicit in soliciting investors to invest in an entity which had no real intention of listing and whose sole purpose appears from the DTI Report to benefit the directors and related individuals.

[107] The DTI report and other documentation in our possession reveal a

litany of Companies Act, corporate governance breaches and questionable share transactions. Promised listing by RSI, MATRIC and GAREK failed to materialise.

[108] Upon enquiring with the JSE, as to the listing position of GAREK, Mr Gary Clarke the JSE company secretary confirmed in July 2008 that 'No documentation was, or has ever been submitted.'

[109] In respondents letter dated 25th February 2005 referred to earlier he states:

> '*I am in the fullest confidence that the Directors, Management and the Professional Team is* (sic) *having all the investor's best interest at heart. This opinion is not made only from what I hear is happening in the company, but is based on all the facts that I have assured myself by visiting the offices and attending meetings in Johannesburg on a regular base* (sic)*'*

[110] One of the first and most basic checks to ascertain the financial soundness of a company is, of course, the financial statements. The fact that financial statements are outstanding, as is evident in this case is the first sign that all is not well with the entity concerned. Had respondent taken this basis step, he would have been alerted to the fact that this may not be an appropriate investment to recommend to his clients.

[111] This is such a glaring omission that either respondent failed to check on this or being aware that these important documents had not been completed choose to ignore this and continued to mislead complainants and solicit funds.

[112] Had he in fact assured himself of all the facts as he contends in his letter there is no basis on which he could have made the statement that:

> 'The company have (sic) achieved outstanding results.' Quite simply this is an untruth.

[113] It is inconceivable that the continued delays in listing and complex share transactions without any legal or substantive commercial basis, particularly considering that the companies themselves had no assets, would not have alerted respondent.

[114] Respondent's role as part of 'marketing team of GAREK.' and the lucrative commissions paid by GAREK no doubt clouded his judgment.

[115] In fact so much so, that I am inescapably drawn to the conclusion that by his actions respondent may have been complicit in a fraud perpetrated against innocent investors.

In the event of any contraventions of the Act, whether such contraventions led to a loss.

[116] Complainants acted on the advice of respondent. The investment was inappropriate and numerous contraventions of the Code are evident. But for these contraventions and misrepresentations complainants would not have invested in GAREK.

[117] According to the DTI report of the R74, 046,875.99 invested in the companies only R299, 061.89 remained in the bank account. As none of the 'funds appear to have been utilised for any acquisition of assets' coupled with the number of shares in existence running into the billions, there can be no doubt that complainants shares are worthless.

[118] I have no doubt that the many violations of the Code were deliberate, and as such in inducing complainants to invest with GAREK he knowingly placed them at risk from inception.

[119] In the circumstances, I deem it appropriate not only that complainants be placed back in the position which they were prior to the investment but that interest thereon be awarded from the 30 December 2004, the date of investment.

E. CONCLUDING REMARKS

[120] In letter dated 19th January 2007 replying to initial correspondence from this Office, respondent stated:

> **'It appears that Mr. Hare still does not understand what the company is all about.'** My emphasis

Regrettably this statement is correct but not in the manner which respondent intends. Quite simply there is no way, complainants could have understood the *raison d'être* of the company or the role played by respondent in the facilitation thereof.

[121] Respondent vacuumed up clients into this scheme and in doing so provided a ready source of funding both for the perpetuation of the scheme as well as very lucrative commissions for himself.

[122] GAREK itself provided the financial product being the shares. In fact it is abundantly clear that the packaging and marketing of shares through its broker network is the primary source of income.

[123] The complainants in this instance are undoubtedly just the tip of the iceberg. In the version of an another GAREK/MATRIC complaint, the complainants state:

> '*He (the respondent) also shoed* (sic) *us investments of retired*

people who basically took their complete retirement to the value of R1,5 m and 2.65m and invested with Matric.'

Herein lies the real tragedy; retirees who can least afford to gamble with their retirement capital are induced into shady investment schemes peddled by unscrupulous intermediaries.

[124] Alarmingly this is an all too familiar pattern of events. In this regard I recall 'The Final Report Of the Commission Of Inquiry Into The Affairs Of The Masterbond Group And Investor Protection In South Africa' the (Nel Report[1]) which in volume 1 at paragraph 1.12 states:

> 'The typical investor is thus in an invidious position. Encouraged and even compelled by circumstances to save and invest, the investor has little control over the investment and is completely at the mercy of the regulating and supervising authorities, the issuers of securities, intermediaries, auditors, and the directors and officers of corporations and other entities. If one or more are incompetent or dishonest, financial security is at risk.'

[125] In volume 2 of the same report, at paragraph 13.12 the text of a consultation paper states:

> 'During the late eighties and early nineties the systems designed to protect investors in South Africa Failed and

[1] *www.justice.gov.za/**commission**s/comm_**nel**.htm*

> hundreds of millions were lost by small investors, many of them pensioners. The systems are still failing with disastrous effects for the victims, many of whom can never recover financially.'

[126] Is history doomed to repeat itself and as such must we continue to fall prey to the same schemes and scamsters that we were so clearly counselled against by Judge Nel. Far too many of these same fraudsters continue to reinvent their schemes seemingly safe from any form of sanction.

[127] The question that must now be asked is whether there is anything that we can do to thwart their efforts.

[128] The oft heard answer is frequently a call for greater regulation. Such calls whilst frequently not without merit and no doubt made with the best of intentions are often misguided.

[129] All too often the legislation exists but lacks effective enforcement. Various regulatory bodies subject to ever increasing divergent legislation operate in silos, with little if any dissemination of information.

[130] In the present instance respondent promoted the fact that he was FSB authorised to solicit business. Effectively his authorisation did not allow him to render financial services in unlisted shares at the time. His

licence was only upgraded in 2007 when he was authorised to sell shares.

[131] The warning signs were certainly there, given that the letter authorising the DTI Report is dated 23 December 2005. Respondent's license was only withdrawn in November 2009.

[132] The inspection was launched in terms of section 259 (2) of the Companies Act which allows the Minister to appoint inspectors to investigate the affairs of a company, if it appears to him that the business is being conducted for a fraudulent or unlawful purpose.

[133] Section 424 (3) provides that any person who was knowingly a party to the carrying on of a business, recklessly or with intent to defraud creditors of the company or creditors of any other person or for fraudulent purposes shall be guilty of an offence.

[134] Now whilst section 261A of the Companies Act understandably prohibits an inspector from disclosing information acquired in the course of performing his or her duties, it does allow an exception if the disclosure is in the public interest and the Minister has authorised the disclosure in writing.

[135] Such disclosures would serve the dual purpose of placing the public on

their guard and alerting additional regulatory bodies to possible transgressions of their governing legislation.

[136] Ideally collective co-ordinated action would then follow. This would include not only the scheme but, as in this instance the brokers who effectively source the funding on which the scheme survives.

[137] In my view, what was lacking here was a means to ensure effective dissemination of information amongst relevant institutions, coupled with a co-ordinated plan to devise an appropriate means of applying the relevant legislation.

[138] Whilst the DTI Report has quite rightly called for consideration of criminal prosecution, I have no doubt that earlier and more co-ordinated action would have gone a long way to protect investor's savings.

[139] Far too often, those who contravene legislation escape prosecution and clearly encouraged by the lack of enforcement go on to perpetrate other schemes.

[140] As an example, many of the individuals involved in the Leaderguard Forex scheme reported on by this Office, learned to ply their trade in earlier schemes. It is sad to note that to date there has not been a single conviction despite the loss of countless millions of investor's

money.

[141] GAREK is in many respects no different given that the scheme evolved from RSI to MATRIC and then GAREK.

[142] Clearly, there is a pressing need to ensure greater co-ordination and effective co-operation between regulatory bodies.

F. RECOMENDATIONS

[143] If ever there is a need for financial products to be subject to some form of approval before they are marketed to members of the lay public then this case makes out a compelling case for such action to be taken. This can be in the form of some kind of state sanction that the product is safe to be marketed to members of the public. This call is in the interests of investor protection and invariably in the interests of the integrity of the financial services industry. To have intermediaries with little or no expertise simply marketing products that have not been sanctioned by some qualified state institution will mean that the public interest will not be served and that consumer protection and the integrity of the financial services industry will continue to be undermined. It is therefore recommended that the Minister of Finance consider appropriate legislation to put an end to the kind of abuse that is evident in this case. To do otherwise would be to simply leave vulnerable consumers to the mercy of market forces motivated by

nothing more than greed and irresponsibility.

[144] In closing whilst I echo calls for ‘consideration of possible criminal prosecution of directors’ and officers’ of GAREK, I extend this to the financial services providers such as respondent that assisted to market this product.

[145] Additionally I call for greater co-operation and co-ordination between regulatory bodies. This can be effectively achieved through a co-ordinated and co-operative arrangement between the various state institutions that currently regulate financial services in South Africa.

[146] In view of its involvement in this matter, I also recommend that a copy of this determination be forwarded to the Minister of Trade and Industry.

[147] It is also recommended that a copy of this determination be forwarded to the South African Police Services, Commercial Crimes Unit for consideration of further investigation into alleged fraudulent activities by the promoters and marketers of this scheme.

Turning to the complaint at hand, I make the following order:

ORDER

The complaint is upheld and;

1. The respondent is hereby ordered to compensate the 1st complainants in the sum of R30, 000.00 and the 2nd complainant in the amount of R10, 000.00;

2. Interest on the aforesaid amounts shall accrue at the rate of 15.5 per cent from 30 December 2004 to date of final payment;

3. The respondent is ordered to pay the case fee of R1, 000.00.

DATED AT PRETORIA ON THIS 24 DAY OF FEBRUARY 2010

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CHARLES PILLAI
OMBUD FOR FINANCIAL SERVICES PROVIDER