IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS PRETORIA

CASE NUMBER: FAIS 03366/13-14/ GP 1

In the matter between:

RENIER LOMBARD **Complainant**

and

PIONEER FINANCIAL PLANNING (PTY) LTD **First Respondent**

MARK COLLEY **Second Respondent**

DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT, 37 OF 2002 (the Act)

A. INTRODUCTION

[1] The complaint arises from investments made by complainant into Unregulated Collective Investment Schemes (UCIS), offshore, on advice of respondent. The respective funds encountered liquidity problems sometime after the investments were made. Investors' money has been trapped in these funds ever since, with only few investors receiving refund of their capital.

[2] The basis of complainant's complaint is that respondent advised him to invest in these high risk schemes, which complainant claims were incompatible with his personal circumstances. What follows is the determination.

B. THE PARTIES

[3] The Complainant is Renier Lombard, an adult male pensioner residing in Gauteng. His full particulars are on file with the office.

[4] First respondent is Pioneer Wealth Managers (Pty) Ltd, registration number 1999/017409/07, a company duly registered in terms of South African laws, with its business address noted in the regulator's records as First Floor, 54 On Bath, 54 Bath Avenue, Rosebank, 2192.

[5] First respondent is a licensed financial services provider as provided for in terms of the FAIS Act, with license number 7007. The license was issued in February 2005 and is still in force.

[6] Second respondent is Mark Colley, currently noted in the regulator's records as a representative of Anchor Capital (Pty) Ltd, license number 39834. At the time of the advice, second respondent operated under the license of first respondent as its representative. At all times material hereto, second respondent rendered financial services to complainant on behalf of first respondent.

[7] For convenience, I refer to first and second respondents simply as respondent. Where appropriate I specify.

C. BACKGROUND

[8] UCIS[1] such as Brandeaux and Glanmore are considered high risk and speculative investments, suitable only for high net worth, or sophisticated

[1] Read more about these schemes from the Financial Conduct Authority UK on www.the-fca.org.uk/consumers/unregulated-collective-investment-schemes

investors who are prepared to take on a high degree of risk with their money. UCIS can be characterized by a high degree of volatility and or illiquidity[2].

ABOUT BRANDEAUX

[9] Brandeaux[3] operated as a dual asset fund which was domiciled offshore and structured as an UCIS, with its assets allocated between student accommodation and ground rent properties. Brandeaux's objectives, as noted in its fact sheet, were to provide long term positive returns and capital appreciation.

[10] The fund was a 'mark-to-model'[4] investment and consisted of two elements; physical property and cash flow coming from rental income and property management. For reasons unknown to this office, the fund was marketed as a low to medium risk, when it was in fact high risk. The fund was eventually suspended during July 2013 by the Financial Conduct Authority of the United Kingdom, after Brandeaux was unable to meet capital redemption requests from its clients.

[11] In a complaint involving an investment in Brandeaux, namely, *D v Baker Tilly Financial Management Limited* [5], the Financial Ombudsman Service, (FOS) of the United Kingdom, remarked that the Financial Conduct Authority (FCA) had expressed the view that:

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2 See speech by Linda Woodall, Head of Savings & Investments, FSA (14 December 2010) http://www.fsa.gov.uk/library/communication/speeches/2010/1214_lw.shtml

3 Information obtained from the Brandeaux Fact Sheet 04/2013 (www.brandeaux.com)

4 Assets that are marked-to-model either do not have a regular market that provides accurate pricing, or valuations rely on a complex set of reference variables and time frames. This creates a situation in which guesswork and assumptions must be used to assign value to an asset. (http://www.investopedia.com/terms/m/mark_to_model.asp)

5 Ref DRN 8681528, November 2013, www.ombudsman-decisions.org.uk

"UCIS are high risk, speculative investments which are unlikely to be suitable for the vast majority of retail customers".

The FCA had in fact described the risk in UCIS in the following terms:

"As with most other investments, a client investing in UCIS could lose some or all of their money. However, the risk is likely to be particularly relevant to UCIS. UCIS frequently invest in assets that are not available to regulated CIS (for example, because they are riskier or less liquid), or are structured in a way that is different from restrictions aimed at ensuring a prudent spread of risk. As a result they are generally considered to be a high risk investment and you should always ensure that clients understand the risks before investing".

GLANMORE[6]

[12] The Glanmore Property Fund, (Glanmore), a UCIS, invested in commercial property. Glanmore had a significant level of borrowing[7] with a view to enhance investors' returns. The truth, which is always down-played about gearing (borrowing) is that it tends to magnify investors' losses, in the event asset values decline and continue to do so for an extended period.

[13] Glanmore experienced financial problems as a result of, amongst others, reduction in the value of the underlying properties. It had a high level of debt and was not able to generate sufficient cash flow to meet its obligations. Redemptions from the funds were eventually suspended.

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6 Information obtained from the Fund Fact Sheet as well as the prospectus

7 *B v Kevin Neal Associated Limited* Ref DRN6468908 Financial Ombudsman Service UK **www.ombudsman-decisions.org.uk**

[14] As with the Brandeaux investment, the FCA considered this type of investment as high risk, rarely suitable for most investor's portfolio.

ABOUT COMPLAINANT

[15] During 2006, complainant approached respondent with a view of reassessing his financial position; he was 57 years of age at the time. Complainant was employed as an Export Administration Manager and retrenched by his employer in 1996 at the age of 47. He had invested his retrenchment pay-out with local insurers[8] but was of the view that, because of the state of the economy at the time, an offshore investment might be better suited to his circumstances. In the years subsequent to his retrenchment, complainant struggled to find employment. He did however, hold two jobs, albeit for short periods of time. A retirement annuity held by complainant also matured in the interim and this was utilised to purchase a living annuity to provide him with an income.

[16] The possibility of re-employment became increasingly slim and complainant wanted to ensure that the funds he had saved to date would be sufficient to sustain him and his wife when she retired in 2011. Complainant no longer wanted to carry any high risk investments, thus, he gave the mandate to respondent to move his money to more conservative investments.

[8] Sanlam, MCubed and Investec

ABOUT THE INVESTMENT

[17] Upon advice from respondent, a 5-year endowment policy[9] was secured with insurers African Harvest / Scottish Life in the amount of €132 545.78[10]. The underlying investment consisted of two UK UCIS, namely, Brandeaux and Glanmore. This amount consisted of complainant's entire life savings. Respondent is alleged to have assured complainant that investing in property in the United Kingdom is tantamount to "having cash in the bank".

[18] The investment commenced on 16 July 2007. During the course of the investment, complainant regularly received detailed statements, originally from Sygnia Life Limited, then Scottish Life International and finally Royal London 360˚, detailing various charges levied or payable. Complainant alleges that the charges on the statement were in excess of those indicated in the original policy document and not agreed to by him. These charges included:

18.1 portfolio administration fee (charged quarterly in arrears);

18.2 initial service fee (charged quarterly in arrears);

18.3 annual management fee (charged quarterly in arrears); and

18.4 an annual advice fee.

[19] The investment value depreciated substantially over time. At the time of lodging the complaint in July 2013, the value was less than 50% of the initial investment. In fact, complainant, on 21 May 2012 received correspondence from Royal London 360˚ advising that the cash account in his policy was overdrawn. He

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[9] It is noted in the policy schedule that the amount of benefit payable by the insurer would be the realisable value of the underlying investments in the investment portfolio, less all fees, charges and other costs and deductions. Furthermore, it was a single premium policy.

[10] At the time of the issuing of this determination, the rand value of the said investment equated to R2 130 282.40

was advised in the same letter to rectify the situation. The policy conditions apparently indicated that complainant should retain 3% of the value of the investment in the cash account to cover transaction fees and charges. Given complainant' financial position, he was unable to comply with the request.

[20] It was during the course of 2012 that respondent informed complainant telephonically that the investment accounts had been suspended and complainant was requested not to deposit any funds as per the request from Royal London 360 Insurance Company Limited. The charges however continued, further eroding complainant's capital.

[21] A statement dated 27 February 2015 provided by complainant, confirmed that the value of the investment had diminished by 84.2%, of the initial capital.

D. THE COMPLAINT

[22] Complainant's case against respondent is that the latter gave him advice that was inappropriate given respondent's knowledge of his personal circumstances. Complainant claims that his mandate to respondent was to minimize risk whilst striving for capital growth and a high after tax return. Complainant anticipated that by the time his wife retired in 2011, the investment would have grown sufficiently to ensure their household a comfortable monthly income when combined with his wife's pension. Complainant claims that apart from dealing with bleak retirement prospects, his financial circumstances have also put a strain on his marriage.

E. RELIEF SOUGHT

[23] Complainant seeks repayment of his capital amount. In light of the fact that the quantum exceeds the jurisdiction of this Office, complainant has given written confirmation that he is waiving the amount in excess of R800 000. As such, complainant's claim for purposes of this determination is R800 000.

[24] The basis of complainant's claim against respondent is the latter's failure to render financial services in line with the FAIS Act and the General Code of Conduct, which includes respondent's failure to appropriately advise complainant and disclose the risk involved in the unregulated offshore collective investments.

F. THE RESPONSE

[25] In compliance with Rule 6(b) of the Rules on Proceedings of the Office of the Ombud, the Office referred the complaint to respondent advising him to resolve the complaint with his client. Respondent duly responded on 20 September 2013.

[26] Before I summarise respondent's response, I note that respondent admits to having invested complainant's funds in high risk investments even though he knew that complainant had no capacity to risk his life savings. Respondent went against the results of his own risk profiling, which indicated that complainant had no capacity or tolerance for high risk investments. His response is summarised here below:

26.1 The basis of complainant's mandate in reviewing his portfolio, was capital growth, a high after tax return, or a combination thereof with minimal risk.

26.2 There was no income requirement. Income would be derived from complainant's wife's pension.

26.3 Complainant's profile identified he was a conservative, borderline moderate risk.

26.4 The investment was made by means of an endowment policy, in UK property funds of Brandeaux and Glanmore. The insurers were African Harvest / Scottish Life, both renamed and merged with Sygnia / Royal London 360.

26.5 Complainant had prematurely retired and considered the investment risk to be conservative / moderate.

26.6 Respondent is of the view that the procedural requirements of the General Code of Conduct had been complied with in that a disclosure letter was provided, a risk profile was done, a record of advice was provided and commission was disclosed. Complainant signed the said documentation. I note that respondent refers to commission when the Code requires him to disclose costs.

26.7 Respondent states that an FSP is not responsible for investment performance, which in his view is the basis of the complaint.

26.8 Respondent is of the view that causation cannot be established and considers the economic downturn and lower property valuations in the UK as a *novus actus interveniens*[11].

26.9 It is respondent's view that he was not negligent, in light of the fact that the investment matched complainants' risk profile and calls for the complaint to be dismissed.

[27] Respondent further claims that because complainant's portfolio was overweight in cash (which comprised 60% of his portfolio), he had suggested that complainant reduce this by switching to offshore funds. The record of advice dated 22 March 2007 confirms that the instruction was for:

27.1 €40 000 to be moved from Ansbachter to Brandeaux.

27.2 The $46 000 in M³ to be moved to Aurum Isis Fund ($25 000) and Glanmore Property Fund ($21 000).

27.3 Sanlam investment of $90 000 of which $50 000 was to remain with Investec GS Pan European Equity and $40 000 to be moved to Glanmore Property Fund.

[28] Some weeks after the aforesaid record of advice was completed, respondent called complainant to a meeting. In this meeting, respondent advised complainant to invest the whole investment into the two UK property funds, Glanmore and Brandeaux.

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[11] Translated to mean "new intervening act". An act or event that breaks the causal connection between a wrong and subsequent happenings.

[29] On 20 August 2015, the FAIS Ombud addressed correspondence to respondents in terms of Section 27(4) of the FAIS Act informing them that the complaint had not been resolved and that the Office intended to take the matter to investigation. The letter, *inter alia*, invited respondent to deal with the question of appropriateness of advice, taking into account the risk involved in the investment and respondent's duty to match that with complainants' circumstances. In reply, respondent submitted a further response dated 4 September 2015. In summary, respondent states that:

29.1 Complainant inaccurately describes himself as a conservative investor, seeing that most of his funds were in high risk funds.

29.2 The risk profile as per respondent indicates that there should be potential; for capital growth which cannot be met with a purely conservative risk appetite.

29.3 Respondent maintains that the UK investments were considered low volatility investments with the potential for capital appreciation and disputes the contention that it was high risk investments.

29.4 The economic result cannot be equated to a lack of due skill, care and diligence as provided for in section 2 of the Code.

29.5 Respondent denies that it acted contrary to complainant's instructions by investing all of the funds in the two UK properties. Complainant signed the application form and was therefore cognisant of the underlying investments, so states respondent. Complainant, according to respondent, further made a top-up investment during October 2007 into

the same property funds. Whilst respondent correctly indicated that complainant made additional investments, it was some three months after the original investment, and this was based on respondent's assurance that said investments were safe.

29.6 Respondent further states that the Brandeaux fund has reimbursed investors.

[30] In a final attempt to resolve the matter, correspondence was directed to respondent on 4 December 2015. Respondent replied and apart from requesting a "seriatim response" to the section 27 (4) response dated 4 September 2015 and that the case manager recuse herself from the matter, no new information was received.

G. DETERMINATION

[31] The following issues arises for determination:

31.1 whether respondent, in rendering financial services to complainant, violated the Code and the FAIS Act in any way. Specifically, the question is whether complainant was appropriately advised, as demanded by the Code; and

31.2 in the event it is found that respondent breached the Code and the FAIS Act, whether such breach caused the loss complained of; and

31.3 quantum.

Whether respondent in advising complainant, breached the Code and the FAIS Act?

[32] Before I deal with this issue, I must first deal with respondent's defence that the complaint is based on investment performance, which means, in terms of the Rules on Proceedings of this office, the complaint is not justiciable before the Ombud.

[33] It is apparent from respondent's own version that he invested complainant's life savings contrary to complainant's risk capacity and tolerance. All that respondent has managed to state is that the funds into which complainant's money was invested were conservative. I deal with this in detail later in this determination.

[34] It is abundantly clear from respondent's version that he had not carried out any work to familiarise himself with the risk involved in the two funds, Brandeaux and Glanmore. For the respondent to even suggest that the risk in involved in the two unregulated collective investment schemes was conservative shows that respondent had no understanding of what he was doing, yet he advised complainant the funds were in line with his risk profile. Unregulated collective investment schemes, the world over, are known as high risk investments, not suitable to conservative clients. On this basis alone, respondent should be held liable for complainant's losses.

[35] As if that was not enough, respondent switched from his original position and advised this office that complainant was not really conservative, only his funds

were conservatively invested. This is notwithstanding the results of his risk profile, which showed complainant as a conservative investor.

[36] Complainant relied on, and trusted the advice of respondent. As will be demonstrated below, complainant lost his money because of respondent's advice which saw complainant invest his life savings in the two high risk funds. The complaint is about appropriateness of advice and is justiciable.

Record of advice and risk profile assessment

[37] Two critical documents are central to this inquiry; they are, the record of advice and the risk profile assessment. The record of advice is maintained by providers to meet the demands of section 9 of the General Code for Authorised Financial Services Providers and Representatives, (the Code) while the risk profile is provided for in section 8 (1) (c).

[38] The record of advice is a four paged document. Upon perusal, it immediately becomes clear that the document lacked vital information such as, complainant's assets and liabilities, income and expenditure and other relevant personal information that would have enabled respondent to better appreciate complainant's capacity and tolerance for risk.

[39] I have already alluded to the fact that, despite the outcome of the risk analysis, respondent persuaded complainant to invest his retirement funds in the two UK based UCIS. Respondent does not dispute this. What is further concerning is that nowhere in this document is there any indication that complainant was made aware of the high risk involved in the underlying investments. This does not

come as a surprise, since respondent has repeatedly argued that these funds carried minimal risk. I note that respondent, despite invitation, has not provided a single shred of information he relied on to conclude that the underlying funds were conservative. I must conclude that respondent realised that all available literature and other publicly available information about these funds points to one thing only; that the two funds were high risk.

[40] In addition, respondent's record of advice does not state what it is in complainant's circumstances warranted this high risk investment. In a word, the record of advice is not helpful. This marks a violation of section 9 which requires that the provider state briefly the reasons the recommended product is likely to address complainant's needs and circumstances.

[41] Contrary to the provisions of section 8 (1) (d) of the Code which provide that where a financial product is to replace an existing product, wholly or partially, the actual and potential financial implications, costs and consequences be fully disclosed to client. There is no evidence that respondent complied with the aforesaid, seeing that the proposed investment into UCIS replaced a number of existing investments. In so far as costs are concerned, on respondent's version, he only disclosed commission. Nothing was said of the rest of the charges mentioned in paragraph 18 of this determination.

[42] There is no indication that following respondent's change of heart as far as the original advice provided is concerned, that an updated record of advice was provided to complainant, nor is there an explanation of the risks inherent in the investment.

[43] The risk profile document shows selections made by complainant, namely:

43.1 Complainant indicated that he was less than 5 years away from retirement.

43.2 As far as choice of investments are concerned, complainant indicated *"an investment that is unlikely to lose money, but will only show a small amount of growth".*

43.3 In respect of investments in shares, equity or unit trusts and how comfortable complainant was at the time, he selected *"...I am uncomfortable with the risk of losing money……".*

43.4 In response to the question on the reaction, should investments decline significantly in value, complainant indicated that he would be very concerned.

43.5 His primary goal was retirement, with income levels ranging between 6 – 10% within the next 3 – 5 years.

43.6 The percentage of complainant's overall savings was noted as more than 75%.

[44] Notwithstanding the information gathered by means of this risk profiling assessment, respondent still went and invested complainant's retirement savings in an investment he knew nothing about, while persuading complainant that the investments were in fact low risk.

[45] I accept that respondent would not have foreseen that the funds were going to fail or be closed down by the UK FCA however, it was sufficient that respondent had not perused even publicly available information regarding the unregulated nature of the funds, the levels of gearing, and the implications for complainant. On the question of lack of regulatory oversight, respondent up to this point has still not provided a single piece of information that shows he satisfied himself on any other governance arrangements that he took into account, which were aimed at protecting investors against director misconduct, blatant violations of the law and possibly, fraud. He further does not provide any evidence that he advised complainant about the implications of lack of regulatory oversight.

[46] In the matter of *ACS Financial Management CC and another v PS Coetzee*[12] the Appeal Board pointed that:

"The question is whether the advice was bad and negligently given, and whether the collapse of the scheme and any concomitant financial loss were causatively connected to that negligence……..An issue of material importance is whether Bluezone's collapse was caused by supervening fraud after the respondent invested, as alleged by the appellant's attorney, or whether the collapse was due to a reasonably foreseeable weakness in the scheme which should have dissuaded Ms Snyman from recommending the investment."

[47] All indications are that respondent had no appreciation of the risks inherent in the products he recommended and was out of his depth. This, respondent could have easily gathered from studying information made available in the funds' fact sheets, the prospectuses or disclosure documents or equivalent documents. As

[12] Before the Appeal Board of the Financial Services Board, 26 February 2014

stated above, it does not appear that the unregulated nature of the investment raised any warning bells to respondent.

[48] The risks inherent in these investments are so complex, they are comprehensively covered in over three and a half pages in the Glanmore Prospectus. As stated earlier, the Brandeaux fund was a mark to model fund, which means there were limitations in accurately pricing the underlying securities including the fact that the values [of the securities] relied on a set of complicated variables, which essentially saw the pricing of the securities left to guess work. None of these raised any governance warning bells to respondent. In fact, from the facts of this case, it is reasonable to conclude that respondent had not done any research on this investment to appreciate the risks. The record of advice is silent and does not provide any indication that respondent even dealt with this aspect in his advice. To invite a 57 year old to invest his life savings into an investment which essentially is wheels within wheels and assuring them that the investment is low risk, is reckless.

[49] Had respondent complied with his duties under the Code, he would not have allowed complainant to make the said investment. The reality that the investment was high risk and that complainant could lose his capital should have been disclosed as required by section 7 (1) (a) of the Code. The section calls upon providers other than direct marketers to 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***. (*My emphasis*). There is no

indication that respondent explained this to complainant. Had respondent done so, in all probability complainant would not have gone ahead with this investment knowing that he was retiring in five years.

Did respondent's conduct cause the loss complained of?

[50] Respondent does not dispute that complainant made the investment based on his advice.

[51] Complainant's explicit request to respondent was that the latter grow the investment with minimal risk in preparation for his retirement. It is not in dispute that respondent went against this request.

[52] Respondent further undermined the result of his own risk assessment, which indicated that complainant had no tolerance or capacity to lose his retirement savings, and invested the funds in the two high risk funds.

[53] All evidence suggests that respondent violated the law. The information at this office's disposal points to the following conclusions:

53.1 Had respondent followed the Code, he would not have recommended an investment in UCIS. Being acutely aware of complainant's circumstances, he would have found an investment that was commensurate with complainant's circumstances;

53.2 Respondent failed to conduct his due diligence on the said investments in contravention of section 2 of the Code. Had respondent done so, he would have realised that the funds were high risk and looked elsewhere with complainant's funds;

53.3 Having failed to conduct due diligence, respondent did not disclose his lack of knowledge to complainant. Instead, advising complainant that his investment was safe, prompting additional contributions from complainant.

53.4 Respondent's conduct undermined the provisions of Code in particular section 2 of the Code.

[54] Accordingly, respondent's conduct caused complainant's loss.

H. FINDINGS

[55] In the premises, based on the reasons set out in this determination, I make the following findings:

55.1 I accept complainant's version as more probable, given the supporting evidence from respondent's own records.

55.2 I find that respondent failed to render financial service honestly, fairly with due skill, care and diligence and in the interest of client and integrity of the financial services industry, thereby contravening Section 2 of Part II of the General Code of Conduct.

55.3 Respondent's caused complainant's loss.

I. THE ORDER

[56] In the result, I make the following order:

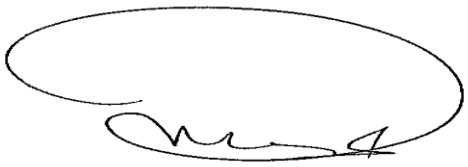
1. The complaint is upheld;

2. Respondents are ordered to pay complainant, jointly and severally, the one paying the other to be absolved, the amount of R800 000;

3. Interest on this amount at the rate of 10.25% per annum from the date of determination to date of final payment.

4. Upon full payment of the amount of R800 000, complainant must hand over to respondents the original documents evidencing this investment, such that respondent is in a position to claim the amount of R800 000.

DATED AT PRETORIA THIS THE 12th DAY OF SEPTEMBER 2016.



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OMBUD FOR FINANCIAL SERVICES PROVIDERS