IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NO: FOC 661/05/GP/(1)

In the matter between:

DESIREE LUDEWIG **1st Complainant**

TYRAN LUDEWIG **2nd Complainant**

and

JOHANNES CORNELIUS VAN DER MERWE **1st Respondent**

JOHAN C VAN DER MERWE MAKELAARS BK **2nd Respondent**

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

A. INTRODUCTION

[1] This is a determination concerning an investment in Leaderguard Spot Forex. The background and investigations conducted into Leaderguard Spot Forex (1LSF2) and its South African marketing arm, Leaderguard

Securities (1LSâ) have been comprehensively set out in the case of Mackrory v Naude FOC 14/05/GP/ (1) and determinations following thereon, including the determination of Comrie and Another v Ewing Trust Company Limited FOC 1807/05/KZN/ (5), which is released simultaneously herewith. I therefore do not propose to set out any more details than are necessary for this determination.

The Parties

[2] First Complainant is Desiree Ludewig, a building contractor, residing at Velling Place 20, Wapadrand, Pretoria, Gauteng Province.

[3] Second Complainant is Tyran Ludewig, an adult male, son of 1st Complainant, residing at Velling Place 20, Wapadrand, Pretoria, Gauteng Province.

[4] First Respondent is Johannes Cornelius van der Merwe, sole member, key individual and representative of 2nd Respondent in terms of the FAIS Act.

[5] Second Respondent is Johan C van der Merwe Makelaars BK, a close corporation registered in terms of the laws of South Africa and a licensed

financial services provider in terms of the FAIS Act with its registered address at 329 Alpine Avenue, Lynnwood, Pretoria, Gauteng Province.

[6] 1st Complainant, acting in her personal capacity as well as in a representative capacity on behalf of 2nd Complainant, at all material times dealt with the 1st Respondent, as authorised representative of 2nd Respondent.

B. THE COMPLAINT

[7] Complainants are seeking to recover the amount of R600 000.00 together with interest. This amount consists of two separate investments of R150 000 and R450 000 made in July and December 2004 respectively. Complainants claim that the investments were made on the on the advice of 1st Respondent.

[8] Following the collapse of the two entities, LS & LSF, Complainants allege that they have lost their entire investment.

[9] Complainants hold Respondents liable for their loss on account of their negligence and non-compliance with the FAIS Act, which they maintain was the direct cause of them investing and subsequently losing their entire investment.

C. THE RESPONSE

[10] In a comprehensive response dated 27 May 2005, Respondents deny any wrongdoing and allege that Complainants were well aware of the type of investment.

Pertinent aspects of the response are that:

[10.1] Respondents cannot be held liable for any loss suffered by Complainants, as they were not negligent in rendering the financial service;

[10.2] Respondents complied with the FAIS Act in rendering the financial service;

[10.3] Respondents have no interest or shares in LSF and cannot be held responsible for any irregularities committed by LSF; and

[10.4] Complainants were interested in a compromise proposal to recoup their funds and, in so doing, the implication is that they waived their right to lodge a complaint with this Office.

[11] 1st Respondent met with Chris dela Guerre, ("dela Guerre") during February 2005 at a meeting held at LSF's offices in Pinmill Farm, Sandton.

Dela Guerre informed the meeting that it was only a matter of days for LS & LSF to be authorised by the Financial Services Board. Respondent submit, they were therefore comfortable in recommending the Leaderguard investment.

Background and undisputed facts

[12] 1st Respondent had acted as financial advisor to Complainants and 1st Complainantõs late husband since 2003. The financial services ranged from business assurance, estate and investment planning.

[13] 1st Respondent introduced Complainants to the Leaderguard investment in July 2004. 1st Respondent provided Complainants with marketing brochures from LSF. Throughout the discussions with Complainants, 1st Respondent simply referred to the product as Leaderguard. At no stage were the individual identities and roles of the various entities spelled out.

[14] 1st Respondent advised Complainants that any loss sustained would be limited to 20 % of their investment whilst 80 % would be secure. Complainants accordingly placed their funds with LSF, as set out in paragraph [7] above, through the intermediation of 1st Respondent. Complainants were to learn when the entities LS and LSF were liquidated, that there was no such thing as 80 % of their investment being secure.

[15] During July and December 2004, a decline in performance to the extent of 3.6 % was experienced. LSF's explanation for this loss, as contained in a letter to investors, was that this was merely a temporary loss which would correct itself.

[16] On 24 March 2005, LS, the South African marketing arm of LSF, filed for liquidation. It was only then that Respondents contacted Complainants to discuss the position. Suffice to say, it was already too late.

Jurisdiction

[17] This Office does not have jurisdiction to entertain the claim relating to the R150 000 invested during July 2004 as the Office only became empowered to deal with complaints in respect of a financial service rendered on or after 30 September 2004. Thus I am, by law, empowered to adjudicate only on the investment of R450 000 made in December 2004.

[18] As far as the allegation of compromise is concerned, no evidence could be found that Complainants signed any compromise proposal. This means that no waiver of rights against any claims can be invoked.

D. DETERMINATION AND REASONS THEREFORE

[19] The issues are:-

[19.1] Whether the Respondents acted in a manner which is not in compliance with the FAIS Act and / or negligently;

[19.2] If it is found that the Respondents acted in a manner which is not in compliance with the FAIS Act and/ or negligently, whether its conduct caused the Complainants to suffer damage or financial prejudice; and if so

[19.3] the quantum of such damage or financial prejudice.

Whether Respondents acted in a manner that is not compliant with the FAIS Act and/ or negligently.

[20] The FAIS Act and the General Code places certain minimum requirements and duties to be complied with when a provider renders a financial service. I set them out below.

[21] Authorisation

[21.1] Since the coming into effect of the FAIS Act, providers are required to obtain authorisation in order to render financial services in respect of particular financial products. It is against the FAIS Act for providers to render financial services in respect of a product for which the provider is not authorised, even if the provider believes that he has the necessary skill and expertise in respect of the product. Respondents had no authority to render financial services on forex investment instruments.

[21.2] In a document dated 10 November 2004, called "Disclosure in terms of the Long and Short-Term Insurance Act" handed to 1st Complainant, under the heading "Mandate & Product Accreditation Details", Respondents state that they are "authorised and accredited" to give advice on all the products listed therein. One of the products listed is that of Leaderguard Spot Forex.

[21.3] Clearly, Respondents misrepresented their authorisation status to Complainants. This flies in the face of Section 3 (1) (a) (i) of the General Code of Conduct for Authorised Financial Services Providers and Representatives ("the General Code"), which requires that when a provider renders a financial service representations made and information provided to the client by the provider must be factually correct.

[22] In addition to the lack of authorisation to render financial services in forex investments, Respondents also did not comply with various other requirements of the General Code. I mention only the most pertinent.

They are:

Suitability

[22.1] In terms of section 8(1)(a) ï (c) of the General Code there is a duty on the financial services provider, prior to furnishing advice, to establish the clientôs needs and objectives and then to identify a product or products that will be appropriate to the clientôs risk profile and identified needs and objectives.

[22.2] Respondents have furnished this Office with what purports to be an analysis of 1st Complainantôs needs. It would appear that on the basis of this document Respondents recommended the investment in LSF. Throughout the document no case or basis is made for the product recommended. Further I do not see any proof that the 1st Complainantôs risk tolerance was ever established. Respondentôs conduct clearly violated Section 8 (1) (c) of the General Code.

[22.3] It is not in dispute that 1st Complainant was unhappy with the performance of her previous investment made through 1st Respondent. This investment had shown a loss of 9.04%. It is for

this reason that 1st Respondent advised 1st Complainant to withdraw from that investment and re-invest with Leaderguard.

[22.4] 1st Complainant in her letter of complaint to the Office avers that she did not want to risk her funds and had communicated this to Respondents. She states in paragraph 17 of her letter that:

> õFinally, I attach for your perusal a client questionnaire where I confirmed a low risk of not more than 20% in the original dollar investment and that my overall investment choice was that of ñmoderateò growthé .ô

Respondents, despite the evidence that 1st Complainant was not prepared to lose more than 20% of her investment, nevertheless exposed her to an investment in which her entire capital was placed at risk. 1st Respondentõs only excuse is that 1st Complainant accepted his explanation and signed for the product. This, in my view, is not a reasonable explanation as to why he recommended this product.

Record of advice:

[23] Respondent failed to furnish this Office with a record of advice in respect of this transaction. A record of advice is required in these circumstances because it is an undisputed fact that Respondents recommended the product into which Complainants had invested.

[24] Section 9 of the General Code requires a provider to maintain such a record to reflect the advice that was given, and in particular, the record must contain a brief summary of the information and material on which the advice was based; the financial products which were considered; the financial product or products recommended and an explanation of why the products were selected.

[25] I have no hesitation in holding that Respondents failed to act with due skill, care and diligence as required in Section 2 of the General Code. I say so for the following reasons:

[25.1] Respondent placed 1st Complainantõs funds in a highly volatile investment, where her entire capital was at risk, without disclosing this to the Complainants. This is in spite of having specific knowledge that Complainants were not prepared to risk more than 20% of their investment;

[25.2] Respondentõs failed to make proper disclosure of the fact that LS was operating under an exemption from the Financial Services Board. Had Complainants known that there was a risk that LSõs licence could at any time be refused; that LSF, the entity into which their investment was made had not been approved, it is doubtful that they would have made the investments. I have noted

Respondentsô contention that they believed that on the basis of information communicated to them by dela Guerre that it was only a matter of days, before LS would be licensed. I do not propose to make any further comments on this aspect, as I have dealt with the role of Dela Guerre firstly as compliance officer and director of LS, and secondly, his role as CEO of FIA and the general influence that he would have wielded by virtue of his office. These comments are made in the determination of Comrie vs Ewing Trust Limited FOC 1807/05/KZN (5), paragraphs 61 to 71.

[25.3] Respondents, and in particular 1st Respondent, did not understand the risks attendant on the product that was recommended. Clearly the information contained in the brochures as to the 20% ôstop-lossô and 80% guarantee were patently false. Respondent because of his own failure to understand the real risk involved in the product was unable to explain this to its client, who then invested to their detriment.

Did 1st Respondent's non-compliance and / or negligence cause financial loss to 1st Complainant?

[26] It has been argued by Respondents that the Complainants wanted to invest in Leaderguard and that it was their decision to invest. Clearly whatever consent or willingness to invest in the scheme on the part of the Complainants would have been based on information furnished to them by the Respondents. As stated earlier in this determination, I could find no basis for the LSF investment being recommended. The only material information pertaining to the investment is about risk. Complainants were told that the limit of this risk, based on the so-called ôstop-lossô was 20%, whilst 80% was secure. It is clear on all the available facts and evidence that Respondents failed to comply with the FAIS Act and were negligent in not disclosing the true state of affairs to 1st Complainant. Proper disclosure would have enabled Complainants to make an informed decision regarding the financial product recommended.

[27] It is clear that Complainants relied on the advice provided by Respondents and acted upon it. This resulted in the loss and prejudice that they have suffered.

Quantum

[28] The Complainants have claimed the sum of R600 000 with interest. These amounts are confirmed by both parties. Of this amount, R150 000, 00 falls outside the jurisdiction of this Office. The investment of R450 000, 00 has not been disputed. Documentary proof in support of this amount has been submitted by Complainants. I am satisfied therefore that the Complainantsôloss can be quantified in this amount.

Conclusion

[29] For all the reasons set out in the determination I find that the Respondentsôconduct was negligent and not in compliance with the FAIS Act. As a consequence thereof, Complainants have suffered financial prejudice.

[30] The complaint is accordingly upheld. Respondents are jointly and severally liable for the loss suffered by Complainants.

ORDER

The following order is made:-

[1] Respondents are hereby ordered, jointly and severally, the one paying the other to be absolved, to pay Complainants the sum of R450 000;

[2] Respondents are further ordered, jointly and severally, to pay interest on the aforesaid amount at the rate of 15,5 % effective SEVEN (7) days from date of this determination to date of final payment;

[3] Respondents to pay the case fee of R1000 to this Office;

DATED AT PRETORIA ON THIS THE 20th DAY OF MARCH 2007

CHARLES PILLAI
OMBUD FOR FINANCIAL SERVICES PROVIDERS