IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 05832/11-12/ EC 1

In the matter between:

PETER WHARTON MACKIE **Complainant**

(In his capacity as the Executor of Estate of Late Ms Clarice Wendy Mackie in terms of the Letters of Executorship issued by the Grahamstown Master of the High Court in terms of section 13 and 14 of the Administration of Estates Act No 66 of 1965 dated 22 August 2014).

and

GERHARDT ARNOLD HATTINGH **Respondent**

(In his capacity as trustee for the time being of Hattingh Business Trust t/a IFS Trust, in terms of the letters issued by the Master of the High Court dated 21 January 1994).

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

A. INTRODUCTION

[1] Complainant, in his capacity as executor of the estate of his late sister, Clarice Wendy Mackie, claims his sister invested funds in property syndication investments, including various Sharemax syndication schemes, following respondent's advice. Respondent does not dispute that over time, a total of

R730 000 of his late client's funds, was placed into various property syndications schemes, as a result of respondent's advice.

[2] It is complainant's claim that respondent knew or ought to have known at the time, that his sister's circumstances were simply unsuited to an investment with high risk. Complainant claims as a result of what he refers to as respondent's negligent advice, he lost the amounts invested in the property syndication schemes and asks this Office for relief in full amount of the invested capital.

[3] Complainant claims that had respondent appropriately advised his sister, the funds would have been invested in investments with a risk profile suitable to his late sister's circumstances.

[4] This determination is concerned with the investments made in Sharemax totalling R100 000. The remaining amount of R630 000 (pertaining to amounts invested in other property syndication schemes), which is the subject matter of an investigation by this Office, will be dealt with in a different determination.

B. THE PARTIES

[5] Complainant is Mr Peter Wharton Mackie in his capacity as Executor of Estate Late Ms Clarice Wendy Mackie[1].

[1] Appointed executor on 22 August 2014 in terms of the Letters of Executorship issued by the Grahamstown Master of the High Court in terms of section 13 and 14 of the Administration of Estates Act No 66 of 1965 which the Office has had sight of.

[6] Respondent is Gerhard Arnold Hattingh in his capacity as trustee, for the time being, of the Hattingh Business Trust trading as IFS Trust[2] (IFS Trust), registration number TM 4747/1, with its principal place of business at 7 Parkview Road, Selborne, East London.

[7] IFS Trust was an authorised financial services provider in terms of the FAIS Act, with license number 15431. The license was issued on 13 December 2004 in respect of category 1.8 and 1.10: shares, debentures and securitised debt.

[8] At all material times, respondent rendered advice to Ms Mackie.

C. FACTUAL BACKGROUND

[9] On or about May 2008, December 2008 and in October 2009, respondent rendered investment advice to the late Ms Mackie Ms Mackie had been introduced to respondent by her brother, the complainant. At the time, Ms Mackie had inherited a sum of money that respondent had invested on her behalf for over a decade.

[10] Pursuant to respondent's advice, Ms Mackie, on 06 May 2008; 09 December 2008 and in October 2009, deposited the amounts of R20 000.00, R50 000 and R30 000 respectively, in the trust account of Weavind and Weavind Inc., the designated attorneys for the Sharemax Investment (Pty) Ltd ("Sharemax") syndication. The total investment was R100 000.

[2] Appointed trustee on 21 January 1994 in terms of Letters of Authority issued by the Grahamstown Master of the High Court in terms of section 6 (1) of the Trust Property Control Act No 57 of 1988 which the office has had sight of.

[11] The amount of R20 000 was for investment in Sharemax Zambezi Retail Park Holdings Ltd, (hereafter referred to as Zambezi); R50 000 in the Villa Retail Park Holdings Limited 1 and R30 000 in The Villa 12. (I refer to the Villa 1 and 12 investments, simply as the Villa.) Upon payment of R100 000, Sharemax issued complainant with certificates for the investments.

[12] At the time of making these investments, the deceased was eighty- eight (88) years old and retired. She lived in a retirement home in East London. The objective was to preserve capital and provide the deceased an income. The funds invested by respondent were inherited by the deceased from her mother's estate.

[13] According to complainant, respondent, prior to introducing the Sharemax investments, had invested deceased's funds quite conservatively and both deceased and complainant were satisfied with the services rendered by respondent in the years preceding the initial Sharemax investment.

[14] Complainant alleges that he became concerned regarding the stability of the investments made in late 2010 following a drastic reduction in deceased's income from about R5000 a month to R1 300 a month.

[15] The reduction came at time when the media was awash with negative publicity about the Sharemax schemes, coupled with the news of the South African Reserve Bank's (SARB) investigation into their affairs.

D. COMPLAINT AND RELIEF SOUGHT

[16] Complainant has asked this Office for the repayment of the full capital of R 730 000 including interest. This determination however, deals only with the investments made in Zambezi and the Villa in the amount of R100 000. The remaining amount, wil be dealt with in a separate determination/s.

[17] Complainant is of the view that respondent violated the FAIS Act and General Code in recommending the high-risk investments to the late pensioner, whose circumstances were incompatible to the high risk Sharemax investment. Since the demise of Sharemax, complainant has received neither income nor the invested capital. Complainant has asked for the return of his capital.

E. RESPONDENT'S VERSION

[18] On 11 June 2015 and 03 June 2016, following referral of the complaint to respondent in terms of Rule 6 (b), of the Rules on Proceedings of this Office, (Rules), this Office sent a notice in terms of section 27 (4) of the FAIS Act to respondent, (the notice).

18.1 The notice *inter alia*, informed respondent as follows:

'The complaint relates to an investment in the Villa Retail Park Holdings, a property syndication scheme promoted by Sharemax Investments (Pty) Ltd.

The prospectuses of both the Villa Retail Park Holdings as well as Zambezi Retail Park Holdings declare that the respective entities have

never traded prior to the registration of the prospectus, have not made any profit whatsoever and are still under construction.

16.1 In the circumstances how did you expect the income to be paid, other than out of investors' money?

The prospectuses refer to the investment as being in an ***unsecured subordinated*** *interest rate acknowledgment of debt linked to a share; which share was in an entity still under construction. Additionally the registrar of companies within the prospectus states 'that the shares on offer are unlisted and should be considered as a risk capital investment.'*

16.2 Given the preceding paragraphs please advise as to why you considered the investment to be anything less than an extremely risky venture, without any substance to its guarantee on interest payments?

16.3 Was your client properly apprised of these risks? Please provide evidence to this effect.

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

16.5 Should you have acted in a representative capacity in rendering the advice, full details thereof are required, along with any supporting documents.

16.6 We require a copy of your license to demonstrate you were licensed to render financial services to clients in respect of this product.'

[19] Respondent furnished the same response provided in reply to the notice in terms of rule 6 (b). The salient features of respondent's response to the notice in terms of section 27 (4) are outlined hereunder:

19.1 Respondent maintains that complainant had been his client since the early 1990's.

19.2 Respondent contends that he had to restructure complainant's investment portfolio to address her increasing income needs and capital security requirements.

19.3 Respondent contends that he placed complainant in Sharemax after he had conducted extensive research and had satisfied himself that Sharemax was best suited to address the late Ms Mackie's needs of income and preservation of capital. To support this allegation, respondent maintains that prior to committing complainant's funds, he personally telephoned the FSB and enquired about the license held by Sharemax. He further alleges that from 2005 till to date[3] he had yet to hear of any negative commentary surrounding Sharemax.

19.4 Respondent attached to the response copies of all the signed and completed application forms for the various Sharemax investments. He

[3] Respondent's response was submitted to the Office on 24 January 2012

maintains that each application form was accompanied by a prospectus stamped by the relevant regulatory authorities.

19.5 According to respondent, his decision to invest in the property syndication was informed by the fact that Sharemax guaranteed a return of 8.9%, escalating at 4% per annum.

19.6 Respondent alleged that he made further investments in Sharemax to satisfy complainant's increasing income needs.

19.7 Respondent further stated…..*…'property per say is just another form of investing as an alternative to cash which provides no Interest guarantee plus the fact that it has no combat to the eroding effect of inflation….By now our combined confidence in the company had grown as every aspect of compliance was adhered to and the company continued to offer an alternative to cash by means of escalating income.'*

F. DETERMINATION

[20] The issues for determination are:

20.1 Whether respondent, in rendering the financial service to the deceased, failed to comply with the General Code of Conduct for Financial Service Providers and Representatives (hereafter the Code). The specific question here is whether the deceased was appropriately advised, which includes advising the client about the risk inherent in the two Sharemax investments;

20.2 In the event it is found that respondent failed to comply with the FAIS Act and/or the Code, whether such conduct caused the damage or loss complained of; and

20.3 Quantum

Whether respondent in rendering financial services to complainant had failed to comply with the Code

[21] In essence the enquiry at hand is whether or not the advice rendered was suitable to Ms Mackie's circumstances at the time. To appreciate the risk involved in the Sharemax investments, respondent had to conduct due diligence on the Sharemax group of companies.

[22] The offer made to the public by Sharemax Zambezi and Sharemax the Villa was communicated via prospectuses. Respondent confirms having had sight of the prospectuses in respect of the various offers and offering these to the deceased. Thus, respondent's efforts in assessing this investment had to include reading and understanding the prospectuses.

[23] In order to get a better appreciation of the risks associated with a property syndication and the kind of disclosures that should have been made in order to properly advise complainant in terms of the FAIS Act, one has to refer to the statutory disclosures contained in the Government Gazette[4], Notice 459 of 2006 (notice 459).

[4] No 28690

[24] The notice contains minimum mandatory disclosures which must be made by promoters of property syndications. The disclosures must be included in the prospectus. By extension, any provider who recommends this type of investment to clients, must deal with the disclosures when advising their client. The aim, as set out in the Gazette, is to protect the public. Some of the most pertinent provisions of notice 459 are highlighted below:

a) Section 1(b) states that:

"Investors shall be informed in writing that:

(i) ***public property syndication is a long-term investment, usually not less than five years****;*

(ii) ***there is a substantial risk, in that the investor may not be able to sell his shares should he wish to do so in the future****;*

(iii) ***it is not the function of the promoter to find a buyer should the investor;***

wish to sell his shares; and

that it is the investor's responsibility to find his own buyer." *(Emphasis mine).*

b) Section 2 (a) requires that investors be informed that funds received from them prior to transfer will be held in an attorney's trust account. But more importantly, section 2 (b) states as follows:

"Funds shall only be withdrawn from the trust account in the event of registration of transfer of the property into the syndication vehicle; or underwriting by a disclosed underwriter with details of the underwriter; or repayment to an investor in the event of the syndication not proceeding."

d) Any direct or indirect interest which the promoter and or any of his or her family member or any other person who is actively involved in the promotion of that syndication has in the property to be purchased, shall be disclosed.

[25] Information available to this Office points to investors' funds being withdrawn from the trust account of Weavind and Weavind and lent to the developer Capicol in contravention of section 2 (b) of notice 459. The information regarding Sharemax' plans of how it intended to utilise investors' funds was not secret; it was contained in the very prospectuses respondent read. Such plans included lending money to the developer, Capicol. Later in this determination, I deal briefly, with the terms of agreement between Sharemax[5] and the developer, Capicol.

[26] I have carefully analysed respondent's responses and cannot find a single reference to the notice. It appears to me that respondent was not even aware of the existence of the notice. Indeed, had respondent been aware, he would have realised that the prospectus undermined the provisions of the notice. In that case, respondent should have immediately ceased advising his clients about this investment. The violation of section 2 (b) of the notice by the Sharemax meant that the directors intended to strip investors of the protection afforded to them by the law. In the face of this affront to the law, respondent advised his client that the investment was appropriate for her circumstances.

[5] The Villa 1, Villa 12 and Zambezi

Up to this point, respondent hasnot tendered any explanation for this aspect of his advice.

[27] I have not seen anything in respondent's papers indicating that he dealt with the requirements of section 2 (d) of the notice, given the overlapping interests in respect of the directors of the promoter, the investment companies, and the property holding companies.

[28] The notice sent to respondent in terms of section 27 (4)[6] on 11 June 2015 had posed a number of questions and pertinently invited respondent to support his response with his records prepared by him at the time of advising his client. For example, respondent was invited to provide information that he had considered and explained to his client how the Sharemax Zambezi and The Villa managed to pay interest when neither company had traded before; and the properties in question were still under construction. Respondent simply did not concern himself with answering the questions.

How Sharemax The Villa and Zambezi paid above average income to investors

[29] An important question to be answered by respondent is how he satisfied himself, at the time of selling these investments, that Sharemax was capable of paying the promised returns. In particular, he had to be satisfied that Sharemax was not using investors own funds to pay these returns. Such a question had to be answered by an FSP seeing as Sharemax promised a return unmatched in the market by any other product provider.

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[6] FAIS Act 37 of 2002

[30] One must also bear in mind that Sharemax paid 6% commission, on the whole capital invested, to the brokers within two weeks of receiving payment of the funds into the attorney's trust account. They also took 10% as an administrative fee and paid commission of 3% to an agent known as Brandberg. Yet, they paid the investors up to 12%. A diligent provider, acting in his client's interests would have invested time and resources to answer this question prior to committing his client's funds to the investment. To make matters worse, investors were paid their income at the end of the month of making the investment, pro-rata. This was simply impossible. If respondent did not question this, then the question is how he could advise complainant about the risks involved in this investment. The only explanation is that investors were being paid a return from their own funds. Incidentally, I note from respondent's response that he had not had sight of a single set of audited financial statements of the group. This would mean that respondent had no resources at his disposal to evaluate this type of investment.

[31] Besides, as was correctly stated in the prospectus, interest earned by investors whilst the funds were in trust belonged to them, and the attorney was supposed to pay the interest directly to the investor. Instead, it was paid out to the directors of Sharemax who did what they pleased with the money. A sign that the directors had no regard for sound corporate governance. This, could have easily been inferred by respondent from the reading of the prospectuses.

[32] The prospectuses also promised to make payment to investors from rental income. This was misleading as there was no shopping mall in the first place and thus absolutely no rental income. In fact, the Villa was never fully built and

while payments were made to investors, such payments could only have come from the investors own funds. This too, could not have been explained to Ms Mackie.

Sale of business agreement

[33] The prospectuses of both The Villa and Zambezi refer to a "sale of business agreement" with Capicol 1 (Pty) Ltd. The prospectuses state that the agreement is annexed to the prospectuses. This was not true as the agreement was never annexed to any prospectus that this Office saw. This agreement was unearthed during investigation and a copy was made available by a director of Sharemax, one Gert Goosen. I notice that respondent did not deal with this document. He obviously did not read it at the time of advising complainant. Nor does he state that he drew Ms Mackie's attention to it.

[34] In simple terms, Sharemax lent the investors' funds to the developer of the shopping malls. If complainant knew that her funds were being lent to the builder, she would know that her funds were at risk and would not have invested. It also made no economic sense that the builder would borrow money from its client, Sharemax, at 14, 5% and be able to pay this back from an independent source of income. Capicol simply paid this interest from the same funds it obtained from Sharemax, namely investor funds.

[35] Respondent relies on the fact that each application form signed by Ms Mackie was always accompanied by a prospectus. Both prospectuses run into seventy pages each, with complicated legal and commercial jargon. Quite simply, there is no way that Ms Mackie could have understood the prospectuses. She relied

wholly on what respondent advised her, that the investment was appropriate for her circumstances.

[36] I have noticed that respondent provided no records to support the advice he had afforded complainant. There is no evidence that the risks mentioned in this determination were ever considered by respondent as demanded by section 8 (1) (a) to (c) of the Code, prior to advising Ms Mackie. Bar the statements that Ms Mackie's income needs could only be satisfied by the Sharemax investment, there is simply no evidence of compliance with section 8 (1) (a) to (c)[7].

[38] The only rational explanation to respondent's conduct of recommending the investment is that respondent was attending to his own interests. To this end, the lucrative 6% commissions paid by Sharemax to intermediaries, [*unmatched by any institution in terms of industry standards*], come to mind. These had "no claw back" provisions. Over the two (2) year period of investing in the Zambezi and The Villa, respondent collected a sizeable commission for what can be seen as the administrative function of providing the prospectus [*which respondent could not appreciate*] to the complainant and facilitating the submission of application forms.

[39] The high watermark of respondent's case on due diligence is the Regulator's issuing of Sharemax with an FSP license. On this point, respondent claimed

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[7] A provider other than a direct marketer, must, prior to providing a client with advice-

(a) take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice;

(b) conduct an analysis, for purposes of the advice, based on the information obtained;

(c) identify the financial product or products that will be appropriate to the client's risk profile and financial needs (own emphasis).

that in the event the regulator had a problem with Sharemax, it would not have issued the latter with a license. There is simply no substance to this. Sharemax's license status was but one of the issues respondent had to take into account. Respondent still had a duty to investigate the Sharemax group of companies, satisfy himself as to the nature of the risk involved and match that to his client's risk capacity.

[40] Respondent had to interrogate the financial statements of the group and satisfy himself about the viability of the offer made to investors. He had to have an understanding of how the group paid investors interest. The failure to carry out these basic checks lead me to conclude that respondent was out of his depth. Respondent could not have appropriately advised the late pensioner about a product he did not understand. Respondent's conduct undermined section 2 of the Code[8].

G. CAUSATION

[41] It is not enough to establish that respondent was negligent or violated the Code, in that he engaged in an activity in which he did not exercise the requisite skill and knowledge. Our authorities have long established that there must be a factual causal link between the negligence and the harm recognised by law (legal causation). In *International Shipping Company (Pty) Ltd V Bentley* [9], the court held as follows:

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[8] 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

[9] 1990 (1) SA 680, pg. 700

41.1"…If the wrongful act is shown in this way not to be a causa sine qua non of the loss suffered, then no legal liability can arise. On the other hand, demonstration that the wrongful act was a causa sine qua non of the loss does not necessarily result in legal liability. The second enquiry then arises, viz whether the wrongful act is linked sufficiently closely or directly to the loss for legal liability to ensue or whether, as it is said, the loss is too remote…".

[42] But for respondent's advice, there would be no investment in Sharemax. This makes respondent's advice the primary cause of complainant's loss. The next enquiry deals with legal causation. The question is whether, as a matter of public and legal policy, it is reasonable, to saddle respondent with liability for the consequences of the failure of the investment. In simple terms, can it be said that respondent, in giving advice that was inappropriate in terms of the Act and the Code, caused the loss suffered by complainant.

[43] It is easy and convenient to impute loss of investors' money to director mismanagement or other commercial causes. In this case however, complainant's loss was not caused by management failure or other commercial influences. If respondent had done his work according to the Act and the Code, no investment would have been made in Sharemax, bearing in mind complainant's circumstances and her stated goals of preserving capital and receiving capital. Had respondent read the prospectus he would have noted the references to the business agreement, and should have raised questions pertaining to how the investment paid such phenomenal returns while being able to absorb costs by way of extravagant commissions to brokers, administration costs and commissions such as paid to Brandberg. The wording

of the prospectus, also clearly proposed to violate Notice 459. In short, not only was the risk of a collapse foreseeable, it was inevitable.

[44] The cause of loss was the inappropriate advice provided by respondent. That the risk actually materialized, for whatever reason, is not the cause of the loss. Otherwise the whole purpose of the Act and the Code would be defeated. Every FSP would ignore the Act and Code in providing financial services to their clients and hope that the investment does not fail. Then when the risk materializes and loss occurs they hide behind unforeseeable conduct of the directors. This will fly in the face of public and legal policy and the provisions of the Act and Code.

[45] The reasonable foreseeability test does not require that the precise nature or the exact extent of the loss suffered be foreseeable: it was sufficient that the general nature of the harm suffered by complainant and the general manner of the harm occurring was reasonably foreseeable. I refer in this regard to the matter of Standard Chartered Bank of Canada v Nedperm Bank Ltd where the Court held that:

"as to the issues of loss and causation, that although the untrue report issued by the respondent had been a factual cause of the appellant's loss, the test to be applied to the question whether the furnishing of the untrue report had been linked sufficiently closely or directly to the loss for legal liability to ensue was a flexible one in which factors such as reasonable foreseeability, directness, the absence or presence of a novus actus interveniens, legal policy, reasonability, fairness and justice all played a part."

[46] Information at this Office's disposal points to the following conclusions:

46.1 Respondent failed to note that Sharemax' prospectuses undermined the law.

46.2 Respondent failed to conduct due diligence on Sharemax.

46.3 It is an undisputed fact that respondent, prior to advising complainant, had not carried out any work to acquaint himself with the legal environment in which property syndications operate.

46.4 Respondent had no means to evaluate the financial viability of the business proposal, yet he advised complainant that her investment was safe.

46.5 Had respondent adhered to the Code, he would have realised that complainant's circumstances were unsuited to invest in Sharemax.

46.6 It was respondent's insistence on selling this investment to complainant, regardless of the surrounding circumstances, that saw respondent violate his duty to act in the interests of his client and the integrity of the financial services.

[47] I find that, in advising complainant to invest in Sharemax The Villa and Zambezi, respondent contravened sections 2; 7 (1) and 7 (2); 8 (1) 8 (2); and 9 of the Code. I also find that respondent's conduct caused complainant's loss.

H. QUANTUM

[48] Deceased invested R20 000 into Sharemax Zambezi Retail Park Holdings, R50 000 into Sharemax the Villa Holdings1 and R30 000 into Sharemax The Villa Holdings12. There is no question that it is the respondent's inappropriate advice that led to complainant's loss. I therefore intend to make an order in the amount of R100 000**.**

I. ORDER

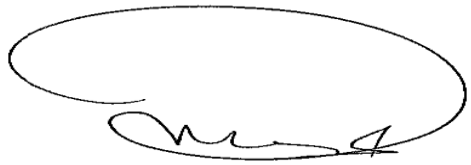
[49] In the premise the following order is made:

1. The complaint is upheld;

2. Respondent is hereby ordered to pay to complainant in his capacity as Executor of the estate of the late Clarice Wendy Mackie the amount of R100 000;

3. Interest at the rate of 10.25%, from a date seven (7) days from date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 30th DAY OF NOVEMBER 2016.



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OMBUD FOR FINANCIAL SERVICES PROVIDERS