IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 02646/11-12/ KZN 1

In the matter between:

GLYNNIS DAWN MORRIS **Complainant**

and

JOHANNES CHRISTIAN MOSTERT **Respondent**

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

A. INTRODUCTION

[1] Complainant was advised by respondent to invest funds into Sharemax Investments (Pty) Ltd (Sharemax), specifically syndication 15 the Villa Retail Holding Limited, on the promise that she would receive an interest rate of 12, 5 % per annum.

[2] Acting on the advice of respondent, complainant invested R 300 000.

[3] Documentation relating to the investment was completed and signed on 7 July 2009.

[4] Subsequent to the investment being made complainant received the monthly income as promised. In July 2010 however all income ceased.

[5] Complainant alleges to have made numerous enquiries with the respondent in an attempt to establish why payment had ceased, but respondent continuously *promised "that any day now my income will start up again".* Complainant however never received any further income from the investment.

[6] Complainant is now of the view that she has lost her investment and asked this Office for assistance in recovering her capital from respondent.

[7] It is important to note that in or around July 2010, at about the same time when payments to complainant ceased, there was wide negative media coverage on Sharemax including suggestions that the South African Reserve Bank was conducting an investigation on Sharemax.

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

[9] The Registrar of Banks concluded in 2010, that Sharemax's funding model was in contravention of the Banks Act.[2]

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

[2] Press Ombudsman Ruling: "Nova Property Group vs. Business", 8 June 2015 http://www.presscouncil.org.za/Ruling/View/nova-property-group-vs-business-report-2790

B. PARTIES

[10] Complainant is Mrs Glynnis Dawn Morris, an adult female pensioner, whose details are on file at this Office.

[11] Respondent is Johannes Christian Mostert, an adult male trading as a sole proprietor under the name and style Medsure Investment Brokers, whose address is 97 Padfield Road, Padfield Park, Pinetown 3610. Respondent is an authorised financial services provider with license number 5553.

[12] The Regulator’s records indicate that respondent was authorised as a financial services provider on 22 December 2004 and the license is still valid. Further, upon perusal of the Regulator’s records it is apparent that respondent was not licensed to render financial services in relation to product category 1.8 and 1.10 at the time.

[13] At all material times hereto complainant dealt with respondent in purchasing this product.

C. COMPLAINT

[14] Complainant’s version can be surmised as follows:

a) Complainant met respondent at her place of work. She was a secretary at a particular hospital and respondent had been visiting a relative who was receiving care at the same institution. They became acquainted and during one of their conversations respondent informed her that he was a broker.

b) Before retiring from her employment complainant sought advice from respondent, on how she could invest her retirement funds.

c) She informed respondent that outside of her retirement funds, which originated from the employer's Provident Fund, she had no other source of income.

d) Respondent recommended that she invest in Sharemax, without, according to complainant, providing an explanation of the associated risk.

e) On the day the funds were transferred from the respective provident fund to complainant, the two met at the complainant's bank wherein respondent is alleged to have completed all the necessary documents and a cheque of R300 000.00 was handed to him.

f) At the time the investment was made, complainant alleges that she did not have any other investments in place.

g) Although complainant cannot say exactly how many years she had known respondent for before he rendered the financial service, she maintains to have known him for quite a number of years.

h) In July 2010 the interest payments to complainant ceased. Complainant contacted respondent who in turn provided her with a letter communicating the decrease in income and further assured complainant that the matter would be resolved.

D. RESPONDENT'S VERSION

[15] The complaint was first directed to respondent in terms of Rule 6 (b) of the Rules on Proceedings of this Office (the Rules) on 17 January 2012 with the response due on 29 February 2012.

[16] On 9 March 2012 a response was delivered through the respondent's attorneys. Instead of providing information and documentary proof showing compliance with the General Code of Conduct when advising complainant in his response, respondent, *inter alia,* questioned the authority of the Ombud as well as her impartiality and the processes of decision making in entertaining complaints and further requested that the matter be directed to a court of law.

[17] At this point it is safe to say that respondent has provided no evidence to sustain his claims. As for the rest of respondent's claims and his request that the matter be directed to court, I note that such requests are not new. In fact these were adequately dealt with in the decision made by the Pretoria High Court in *Risk and Another v Ombud for Financial Services and Others,* wherein it was also held:

> *"the intention of the legislature in framing section 27(5)(a) of the FAIS Act as it presently stands is clear. It was to permit the Ombud institution a measure of **flexibility** (own emphasis) when dealing with complaints. This means that depending on the circumstances and facts of each complaint, the Ombud **may** (own emphasis) adopt procedures which are akin to that of a court hearing".*

[18] The complaint remained unresolved and respondent was notified and accordingly, invited in terms of section 27 (4) of the FAIS Act to furnish this office with his full version.

[19] In the notice respondent was requested to provide a record of advice and any other relevant documents demonstrating compliance with the Code while

rendering financial services to the complainant or alternatively make a reasonable proposal of settlement.

[20] In response to the aforementioned respondent presents the response delivered in March 2012 as his response.

[21] On 24 June 2015, a second 27 (4) notice was sent to respondent. The notice informed respondent *inter alia*, that:

i) he is viewed as a respondent in this matter;

ii) the office shall upon receipt of his response formally commence its investigation procedures; and

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

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

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

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

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

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

b) What information did you rely on to conclude that this investment is appropriate to your 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 clients. (A post facto account will not be accepted.)

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

[24] Respondent’s response can be surmised as follows:

a) The structure of Sharemax and how investors would be paid their monthly interest was fully set out in prospectus on the Villa and Zambezi, *“which was provided to Mrs Morris and explained to her”.*

b) Complainant signed the application form as well as a certificate titled “*Sharemax Investments Risk Assessment on Product Information*”.

c) The prospectus warns the investors that there may be risk in the investments.

d) Ultimately it was the complainant’s decision to invest in Sharemax.

e) The Sharemax prospectus was approved and registered by the department of Trade and Industry as well as the Companies Registration Office.

[25] Respondent further added that the Ombud may not question whether or not complainant could comprehend the legal implications of the information contained in the prospectus as she had not alleged otherwise in her complaint. At this point, I note that complainant specifically stated that the risks associated with the investment were never explained.

[26] Respondent further submitted that *"the Ombud clearly has an extreme dislike for property syndications"* and this is shown in its use of a blanket approach in all property syndication matters.

[27] From his response respondent appears to be well aware that the risks associated with a recommended product must coincide with the client's risk profile. In this regard his response reads:

"The context of risk must be considered in the context of investor's needs and circumstances. I determined that the risk in investing in Sharemax (as set out in the prospectus) was within the risk profile of Mrs Morris". As to how respondent arrived at the conclusion that the risk associated with Sharemax investments was suitable for complainant's circumstances, respondent chose not to provide proof of any form to substantiate his reasoning despite the direct invitation to provide evidence in this regard.

[28] It is worth noting that in the absence of a risk analysis and a record of advice one is not in a position to determine just how respondent concluded that the investment in Sharemax was within the complainant's risk profile and how this was communicated to the complainant.

E. DETERMINATION

Justiciability of the complaint

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

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

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

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

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

[30] Furthermore the complaint was submitted to this Office prior to it having prescribed.

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

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

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

(i) this office considers him as a respondent;

(ii) he could be held liable; and

(iii) the Office would determine the complaint without further reference to him.

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

[33] The issues for determination therefore are:

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

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

(iii) Quantum

Appropriateness of the advice

[34] Respondent was invited through the notice in terms of section 27 (4) to provide a record demonstrating just why this investment was considered appropriate in view of the clients' circumstances. Apart from referring to the prospectus and a statement of his version of events, no records were furnished depicting the clients' financial situation at the time. It must be emphasised that the financial circumstances of a client are pivotal in so far as determining the client's risk profile. The General Code in section 8 (1) (a) to (c) is instructive in this regard.

[35] What is known to this office is that the respondent advised complainant, who was facing retirement, to invest her life savings into Sharemax, without complying with the mandatory section 8. In this regard, one must take cognisance of the fact that there is no record of advice and the only document which purports to be proof of a risk analysis having been done, is the Sharemax standard form, which was simply completed in isolation of what the Code mandates.

[36] The Villa Retail Park Holdings prospectus clearly indicated that the entities involved had never traded prior to the registration of the prospectus and had never made any profit whatsoever. The investment is described in the prospectus as '***an unsecured subordinated interest rate acknowledgment of debt linked to a share'***.

[37] In his response respondent failed to show compliance with section 8 (1) of the General Code and simply stated that the prospectus clearly indicates *"there may*

be risk in the investments" and that *"ultimately it was the complainant's decision to invest in Sharemax".*

[38] The Code demands that clients, to whom financial services are rendered, must be placed in a position where they can make informed decisions. Up to this point, respondent has furnished neither his record in terms of section 3 (2)[3] of the General Code nor his Record of Advice in terms of section 9 and fails to explain why he did not comply with the sections.

[39] Section 8 (1) (c) places an obligation on the provider to identify the financial product or products appropriate to the client's risk profile and financial needs. In responding to how the product was deemed to be in line with his clients' risk profile, respondent indicated that it is his function *"to establish the circumstances and needs of a particular investor (which was done in this case) and then to advise the investor accordingly, by identifying a financial product that will be appropriate for the investor's risk profile* ***and*** *financial needs.*

[40] The aforementioned submission is a mere verbal declaration unaccompanied by documentary proof that indeed respondent had elicited relevant and available financial information from his client in order to appreciate her financial situation, financial product experience as well as her financial objectives.

[41] In the absence of proof of compliance the only conclusion I could reach is that of non-compliance. In fact, had respondent complied with the law, he would have

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

realised that his client had no capacity for the risk associated with Sharemax investments. Considering that at the time of the investment she was at retirement stage, she had no previous experience with Sharemax investments and did not declare any alternative income which would sustain her lifestyle. She was dependent on her pension proceeds.

[42] I now turn to the critical question of advising complainant about the risks inherent in this investment, which is key to arriving at the conclusion that complainant made an informed decision about the investment. I note that respondent provided no evidence of having warned his client that she could lose her capital, in total disregard of section 7 (1) (a) of the Code.[4]

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

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

F. DUE DILIGENCE

[45] Despite being invited, respondent has failed to provide information pertaining to due diligence he undertook regarding the entities of Sharemax, prior to

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

recommending the investment to complainant. This was a violation of section 2 of the General Code.

[46] What exacerbates the situation is that respondent failed to disclose to complainant that he had not conducted any due diligence on the investment and the associated entity, Sharemax, and for that reason, he had no appreciation of the risk involved.

[47] I refer in this regard to Government Gazette 28690, Government Notice 459, which was signed into law in March 2006. In the preamble, the rationale for the regulation is stated quite clearly, and it had to do with combating unfair business practices, which were found to exist in the space of property syndication businesses. Section 2 (a) and (b) accordingly state:

'*Investor protection*

(a) Investors shall be informed, in writing, that all funds received from them prior to transfer/finalisation shall be deposited into the trust account of a registered estate agent, a legal practitioner or a certified chartered accountant and provided that such trust account is protected by legislation. Individual investors are to be given written confirmation thereof. It shall be clearly stated who controls the withdrawal of funds from that account. Such an account shall be designated " XYZ Attorneys/auditors/estate agents Trust Account- the xyz syndication". In the event of investors paying by cheque, promoters shall ensure that the name of the payee is printed in bold on the application forms. (b) Funds <u>shall only be withdrawn from the trust</u> 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.'

[48] It is public knowledge that the directors of Sharemax withdrew investors' funds from the attorneys' trust account, in contravention of the Government Notice, and used, amongst others, to finance the development and pay investors' interest. In this regard, funds were lent to the developer who had the task of building the Villa. The very prospectus that respondent had purportedly read and understood, contained provisions which violated the Government Notice. Given the magnitude of risk and the inevitable harm to investors, respondent does not explain how he found such an entity suitable to complainant's circumstances. Respondent further did not bother to disclose what steps he took to advise complainant about the clauses in the prospectus which had the effect of violating the law.

[49] Yet when asked to explain how he expected the Villa, which was still being developed at time of recommending the investment, to pay income to investors, respondent was quick to point out that all necessary information which would have assisted complainant in her decision making could be found in the Villa Prospectus.

[50] From the aforementioned and respondent's response the only rational conclusion to be drawn is that respondent was out of his depth and did not appreciate the risks associated with the Sharemax investment. Had he bothered to conduct due diligence, he would have noted that the manner in which Sharemax proposed to deal with investors' monies was not in harmony with the

provisions of Government Notice 459, Government Gazette 28690, (the Notice) and immediately rule such an investment out of his offering.

[51] It is a fact that respondent has provided no information to this, as part of his due diligence, which gave him comfort that investors were protected against director misconduct. In his response however, respondent pointed to the registration of the prospectus by the Registrar of Companies. What respondent misses is that the Registrar, in approving any prospectus, does not certify that the investment proposed is suitable to any particular investor.

[52] It is clear from the aforementioned that respondent invited his client to invest in a scheme he could not understand, a scheme, which purported to pay investors above average interest rates, against the backdrop of a sluggish economy when bigger financial institutions were struggling to pay upper single digits returns. It was respondent's duty to carefully analyse the Sharemax business model and satisfy himself what exactly delivered the alleged superior returns and not be blindsided high numbers.

G. CAUSATION

[53] Had the respondent followed the law, first by satisfying himself of complainant's risk profile and conducting due diligence on Sharemax, he would have understood that the investment was unsafe and posed a risk that complainant had no capacity to tolerate at her age. He would have also realised that the investment was not suitable to the complainant's needs as there were insufficient

safeguards against director misconduct or mismanagement, given the flagrant violation of the law in their prospectus.

[54] The issue here is not whether or not a collapse of an institution, for whatever reason, was foreseeable, but whether or not the investment was appropriate for complainant's circumstances, bearing in mind her personal circumstances and tolerance for risk.

[55] It is apparent from respondent's version that he had no idea just what the investment was about and as such, could not appreciate that complainant was lending money to an entity, which entity would in turn lend the funds to a developer, leaving investors with no form of security whatsoever. The very company that would eventually own the property was a private company, separate and distinct to the original debtor. Such is the confusing nature of property syndication structures.

[56] It is this lack of appreciation of the complicated structure of the property syndication and respondent's choice to ignore the law that led to the recommendation of the Sharemax investment to complainant. As a result of respondent's inappropriate advice complainant suffered financial loss.

H. QUANTUM

[57] Complainant invested R 300 000.00 in Sharemax.

Accordingly, an order will be made that respondent pay to the amount of R 300 000.00 plus interest**.**

I. FINDINGS

Based on the facts before me I make the following findings:

[58] Respondent had no appreciation of the risk involved in Sharemax when rendering the financial service, thus he could not match complainant's risk profile to the product.

[59] As shown above he failed to conduct due diligence on the Sharemax investment thereby violating section 2 of the Code.

[60] In further violation of his duty as set out in section 2, respondent was not frank with complainant, in that he failed to disclose his limitations in terms of appreciating the risk involved in Sharemax.

[61] Respondent further did not maintain a record of advice reflecting the basis on which the advice was given, thereby contravening Section 9 (1) (a) (c) of Part VII of the Code.

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

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

J. ORDER

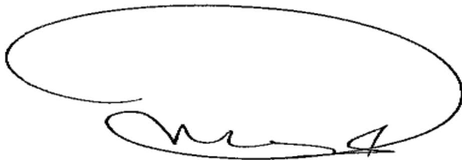
[64] In the premises, the following order is made:

1. The complaint is upheld.

2. Respondent is hereby ordered to pay complainant the amount of R300 000.

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

DATED AT PRETORIA ON THIS THE 18th DAY OF AUGUST 2016.



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