IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 03573/11-12/ WC 1

In the matter between

JACOMINA CHRISTINA MULLER	**First Complainant**
WYNAND MULLER	**Second Complainant**
(In his capacity as executor of Estate Late Jacobus Johannes Muller, in terms of the letter of executorship issued by the Master of the High Court dated 6 March 2008)	

and

IMPECTUS BROKERS & FINANCIAL SERVICES CC	**First Respondent**
FRANCOIS VAN DER WALT	**Second Respondent**
ANDRE JONCK	**Third Respondent**

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

A. INTRODUCTION

[1] This determination follows a recommendation made in respect of section 27 (5) (c) of the Act on 12 December 2017. The recommendation was not accepted by the respondent. The recommendation is attached for ease of reference. It follows that this determination should be read together with the recommendation.

B. THE PARTIES

[2] The first complainant is Jacomina Christina Muller, an adult female pensioner whose particulars are on file with the Office. The second complainant is Wynand Muller, in his capacity as executor of estate late Jacobus Johannes Muller, in terms of the letter of executorship issued by the Master of the High Court dated 6 March 2008.

[3] The first respondent is Impectus Brokers & Financial Services CC, a close corporation duly registered in terms of South African laws, with registration number 1999/000128/23. The first respondent is an authorised financial services provider (license number 11860) with its principal place of business noted in the regulator's records as 31 Market Street, George, 6529, Western Cape. The license has been in force since 20 October 2004.

[4] The second respondent is Mr Francois van der Walt, an adult male and key individual of the first respondent. The third respondent is Mr Andre Jonck, an adult male and representative of the first respondent. Their addresses are the same as that of the first respondent.

[5] At all material times, the third respondent rendered financial services to the complainants. I refer to the first, second and third respondent as "respondent". Where necessary, I specify which respondent is being referred to.

C. RESPONDENT'S REPLY TO THE RECOMMENDATION

[6] A summary of the salient points of the respondent's reply is set out below:

6.1 The respondent reiterated the fact that investment income was most important to the complainants. A diversified proposal was made, however,

an investment in The Heights was the only vehicle that could provide the required income, and as such the option chosen by the complainants.

6.2 The results of the risk profile analysis was discussed with the complainants and it was agreed that the product applied for suited their risk profile. To this extent, they have accepted in writing how the syndication is structured, and that there were no guarantees. The respondent disputes the allegation that the investment was presented to the complainant as "ostensibly risk-free". The complainants' complaint, (in respondent's view), is at odds with their written declarations. Any finding that no reasonable and appropriate explanation of the nature and material terms of the contract were given, is therefore wrong.

6.3 Despite claims that the investment was not guaranteed, the respondent stated that the complainants were in fact assured of the safety of the investments. The respondent claimed that it is based on the findings of the forensic auditors in respect of the value of the building itself. Any questions as to why profitability has decreased, should be addressed to Bonatla.

6.4 The basis of the findings in respect of the lack of an independent board, and failure to adhere to the King reports, are irrelevant in the respondent's view, if regard is had to the findings of the forensic auditor about the value of the property and soundness of an investment in The Heights[1].

[1] Also refer to paragraph 6.8 in this regard

6.5 The product sold was considered medium risk (and not high risk as alluded to in the recommendation), and fitted the profile of the complainants. The complainants received income for approximately 4 years before the Bluezone syndication folded. The product was registered by the FSCA[2] and therefore audited. No warnings were issued about any potential failure, since the financial statements of the products are scrutinized by the FSCA.

6.6 The respondent is of the view that the complainants still hold shares in Bonatla, whom they chose to transfer their shares to. The respondent claimed to have no control of the Bonatla share transfer, and as such the Bonatla investment is removed from the original investment advice given.

6.7 Owing to a valuation done by the Auditors of the Judicial Managers, an investment in The Heights at the time was sound. It was an administration failure at the company which resulted in the company's liabilities exceeding its assets. A financial provider could not have foreseen this, despite the best due diligence investigation. The reference to the remarks of Schutz JA in the Durr matter are therefore misplaced. A reasonable broker in the shoes of the respondent would not have been wrong to advise a client to invest in Bluezone.

6.8 The respondent stated that investments are uncertain, and it is for this reason that clients of financial providers are requested to carefully consider the advice that they receive, to declare that they are fully aware

[2] Financial Sector Conduct Authority, formerly known as the Financial Services Board

of the risks and to sign disclaimers. A financial provider can therefore only be held liable if the advice was grossly negligent.

6.9 The respondent concluded that he complied with section 8 (1) (a) to (c) of the Code, and took all reasonable steps to render appropriate advise.

D. FINDINGS

[7] It is evident from the respondent's reply to the recommendation that he did not understand how the Bluezone structure and the schemes promoted by it worked[3]. It is also important to deal with the perception the respondent has in respect of the responsibilities of the FSCA.

[8] It is a fact that Bluezone had been licensed by the FSCA. The point to note though is that the FSCA does not product regulate the industry. The FSCA therefore does not scrutinize the financial statements of each product promoted by a licensee. It remains the duty of the FSP to satisfy themselves of the risks relevant to a particular product, and match the product with his client's risk profile in line with section 8 (1) (c) of the Code.

[9] Despite the overwhelming evidence provided in the recommendation letter which included the contraventions of Notice 459, the conflict of interest as a result of the roles of the directors and several other red flags which were evident from the summary of the marketing material, the respondent still fails to see the high risk involved in the Bluezone product, and therefore, the inappropriateness of his advice.

[3] See in this regard paragraphs 29-30 of the recommendation which explain the complexities of the Bluezone syndication

[10] The respondent failed to see that by the time he presented the marketing material to his clients, the directors were already contravening the law. It was exactly the lack of governance (which the respondent alluded to is irrelevant), which led to the collapse of the syndication.

[11] It is disingenuous of the respondent to claim that the signing over of the shares to Bonatla, absolves him from any liability as far as inappropriate advice is concerned. The complainants are in this unfortunate position because of the advice rendered by the respondent. Had the respondent informed them that they would be investing their life savings in unlisted shares, linked to a loan account, it is unlikely that they would have proceeded with the investment.

[12] The advice to invest in Bluezone was based solely on the complainants' need for a higher income, or so says the respondent. That the complainant wanted an investment that produced the highest income, does not absolve the respondent from his responsibility to recommend an appropriate product. Should a complainant decline such advice, section 8 (4) (b) of the Code applies.

[13] With reference to the record of advice, quotations were provided for other more traditional products, however, the record points the complainants in the direction of investments in PIC and Sharemax, two other property syndication products who also sold unlisted shares. One cannot compare traditional products to unlisted shares – a fact which the respondent failed to explain to the complainants, or note in the record of advice.

[14] The respondent is further of the view that a financial provider can only be liable if the advice he rendered amounts to gross negligence. Section 16 (1) provides that:

"A code of conduct must be drafted in such a manner as to ensure that the clients being rendered financial services will be able to make informed decisions, that their reasonable financial needs regarding financial products will be appropriately and suitably satisfied and that for those purposes authorised financial services providers, and their representatives, of such code to-

a) act honestly and fairly, and with due skill, care and diligence, in the interests of clients and the integrity of the financial services industry…"

[15] The provisions of the Code are peremptory, meaning that an FSP *must* comply with the respective sections of the Code. Should a breach of the Code occur, the respondent would have committed a breach of contract, in this instance by failing to provide suitable advice. The Act and the Code makes no reference to gross negligence as a consequence to be found liable for the loss a complainant suffer.

E. CAUSATION

[16] The question that has to be answered, is whether the non-compliance of a provision of the Code can give rise to legal liability, whether in contract or delict.

[17] I refer in this regard to the decision of the Appeals Board[4] in the matter of *J&G Financial Service Assurance Brokers (Pty) Ltd and another v RL Prigge*[5]. The Board noted the following:

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[4] Effective 1 April 2018, the Board is now called the Financial Sector Tribunal

[5] FAB 8/2016, paragraphs 41 - 44

"The liability of a provider to a client is usually based on a breach of contract. The contract requires of a provider to give advice with the appropriate degree of skill and care, i.e., not negligently. Failure to do so, i.e., giving negligent investment advice, gives rise to liability if the advice was accepted and acted upon, that it was bad advice, and that it caused loss. And in deciding what is reasonable the Court will have regard to the general level of skill and diligence possessed and exercised at the time by the members of the branch of the profession to which the practitioner belongs.3

In the case of a provider under the Act more is required namely compliance with the provisions of the Code. Failure to comply with the code can be seen in two ways. The Code may be regarded as being impliedly part of the agreement between the provider and the client and its breach a breach of contract. The other approach is that failure of the statutory duty gives rise to delictual liability.

In both instances the breach must be the cause of the loss….."

[18] In the matter of *Smit v Abrahams*[6] two tests were identified: the direct consequences test and the reasonable foresight test. The former was explained as follows[7]:

"The presence or absence of reasonable anticipation of damage determines the legal quality of the act as negligent or innocent. If it be thus determined to be negligent, then the question whether particular damages are recoverable

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6 1992 (3) SA 158 (C)

7 See also in this regard *Foundational Principles of South African Medical Law* Carstens P and Pearmain D (2007), pages 509 – 515 in respect of causation

depends only on the answer to the question whether they are the direct consequence of the act".

Farlam AJ pointed out in the *Smit* case that the principle upheld in the matter of *Overseas Tankship (UK) Ltd v Morts Docks & Engineering Co Ltd*[8] is subject to two qualifications. As long as the "kind of damage" is foreseeable, the extent need not be. Furthermore, the precise manner of occurrence need not be foreseeable.

[19] If the respondent had adhered to the Code, no investment in Bluezone would have been made. The violations of Notice 459 and the poor governance practices meant that investors would have no protection from director misconduct. Not only was the loss to investors reasonably foreseeable, it was inevitable.

[19] The complainants sought investments that would keep their capital intact. For all the reasons mentioned in the recommendation, the investments were high risk and inappropriate for the complainants. That the risk actually materialized, for whatever reason, is not important. Otherwise the whole purpose of the Act and the Code would be defeated. Every FSP can ignore the Act and Code in advising clients and hope that the investment does not fail. When the risk materializes and results in loss, they can hide behind unforeseeable conduct on the part of product providers.

[20] The findings made in the recommendation letter are hereby confirmed.

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8 1961 AC 388 (PC); 1961 1 All ER 404

F. THE ORDER

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

1. The complaint is upheld.

2. The respondent is hereby ordered to pay the complainants the following amounts within SEVEN (7) days from date of this order:

   2.1 To the first complainant – R500 000

   2.2 To the second complainant – R500 000

3. Interest on these amounts at a rate of 10% per annum from the date of determination to date of final payment.

4. Upon full satisfaction of this determination, complainants are to cede their rights and title to the Bluezone investments to the respondents.

DATED AT PRETORIA ON THIS THE 11th of JUNE 2018.

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NARESH S TULSIE

OMBUD FOR FINANCIAL SERVICES PROVIDERS