

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

CASE NUMBER: FAIS 05015/12-13/MP1

In the matter between:-

ALETTA ROOS

Complainant

and

JOHAN DUDOLPH KUNNEKE t/a JOHAN KUNNEKE BROKERS

Respondent

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

A. THE PARTIES

[1] Complainant is Aletta Roos, a widow of Belfast, Mpumalanga Province.

[2] Respondent is Johan Dudolph Kunneke an authorised financial services provider (licence no. 5211) trading as Johan Kunneke Brokers at 33A Pietersielie Place, Palm Gardens, Rooihuiskraal North, Extension 14, 0157. The respondent's license as a financial services provider was issued on 09 May 2005.

B. INTRODUCTION

[3] The complaint relates to the purchase of preference shares to the value of R480 000 in company called MGH Development Corporation Ltd ('MGHDC')¹. According to the certificate issued by the Registrar of Companies and Closed Corporations MGHDC is located in Centurion, Gauteng. Its Directors are Petrus Gerhardus Ackerman and Meldon Stanton Verster.² MGHDC's principal business is real estate activities.

[4] During 2004 and 2006, MGHDC offered preference shares at a par value of R1 per share to investors. Promotional material furnished to potential investors reflect that shareholders would receive a guaranteed annual dividend of ten percent. According to MGHDC, shareholder capital was used to fund research, administration and development cost of identified real estate projects.

[5] In 2006, investors were informed that MGHDC was taken over and incorporated into MGH Developments Holdings Ltd ('MGHDH').³ Shareholders were issued with MGHDH share certificates and were required to return their MGHDC share certificates.⁴ According to the prospectus registered by MGHDH, preference shares were offered to the public at a price of R1, 00, which constitutes of a par value of R0,01 (one cent) and premium of (ninety-nine cents) per share.

¹ This is a public company, registration number 2003/017392/06, which was subsequently converted to a private company, 2003/0179392/07.

² CIPRO enquiry made in July 2014.

³ Public company, registration number 2005/041991/06 – subsequently converted to a private company, registration number 2005/041991/07.

⁴ Where appropriate, I refer to MGHDC and MGHDH as MGH.

[6] It appears from the evidence available to this Office that MGHDH ran into financial difficulties in 2009. The respondent indicated that, although he was not sure, the financial difficulties might have arisen when the National Credit Act of 2005 came into operation, which placed certain limitations to credit grantors. MGHDH was finally liquidated on 13 January 2012.

C. COMPLAINT

[7] Sometime in 1996 following the passing of the complainant's husband, complainant invested monies from his pension in a five year investment. Upon maturity thereof in 2001, a friend suggested that complainant obtain advice from respondent on how to invest the proceeds. The friend described the respondent as a very good, award winning financial advisor, who was also the financial advisor to the friend's daughter.

[8] In May 2001, complainant met with the respondent, who at that stage worked for Vulcan Financial Services ('Vulcan'), a Liberty Life ('Liberty') franchise. Respondent recommended that the complainant invest R620 000, in a Liberty endowment (no. 17896025)⁵ for a period of five years. Subsequent to this investment, the respondent rendered financial services to complainant in relation to more financial products.⁶

[9] In November 2004, respondent informed complainant that he had left Vulcan in 2003 to start his own brokerage known as Johan Kunneke Brokers. It is at that

⁵ Diversified underlying funds: LS PROPERTY CPI and GLOBAL MANAGED.

⁶ For example, life insurance, short-term insurance and savings plan for children

point that respondent proposed what he called, “a brilliant investment”. That brilliant investment was MGHDC, which as a result of respondent’s advice, saw complainant surrendering her Liberty endowment (no. 17896025). Persuaded by the respondent’s assurance that it was a safe investment which would pay complainant a return of 15% per annum, complainant agreed to invest.

[10] According to the complainant, respondent accompanied her to Liberty to surrender her Liberty endowment (no. 17896025). Respondent was confident that the losses, which came as a result of the premature surrender, would be recovered by the MGHDC investment in a short space of time. Shortly after the proceeds were paid into complainant’s bank, an amount of R480 000 was paid into MGH’s bank account.

[11] In 2006, complainant was informed by respondent that she had to enter into an agreement to transfer her shares in MGHDC to MGHDH, which complainant agreed to do. Complainant signed the necessary papers as requested. During the years that followed, she received quarterly investment statements from MGH and subsequently made three withdrawals from the investment, totalling R180 000.

[12] In June 2011, complainant received her last statement from MGH, which reflected that her investment value was R863 376.83. Her attempts to liquidate the investment in order to access cash however, were unsuccessful. Complainant was shocked to learn that that the company was not in a position to repurchase investors’ preference shares and found this to be contrary to an undertaking made by MGH.

- [13] Complainant is disappointed by MGH's failure to re-purchase the investors' shares as she is living off her late husband's monthly pension of R6 200, which she claims is not sufficient to sustain her. She says she agreed to invest in MGH because she trusted respondent's assurances that her money was safe.
- [14] Complainant is further of the view that she will not be able to recover her capital and as a result, has turned to this Office for assistance.

D. RELIEF SOUGHT

- [15] The complainant invested R480 000 and made withdrawals totalling R180 000. She seeks payment of R300 000 from respondent together with interest thereon from date of investment to date of payment. The basis for complainant's claim appears in the determination.

E. SUMMARY OF RESPONDENT'S RESPONSE

- [16] According to respondent, he provided complainant with information about preference shares in MGHDC sometime in 2004. The information was provided in his capacity as an employee of MGH. Respondent however, denies that he provided advice to complainant.
- [17] As for the conversion from MGHDC to MGHDH, respondent asserts that when MGHDC was incorporated into MGHDH, complainant was offered a choice to either take cash or have the proceeds of her shares re-invested into MGHDH. She elected to take part cash and to re-invest the balance into MGHDH. The respondent states however, that he was not involved in this transaction, which he says is the essence of the complainant's complaint. Respondent has

submitted no documents in support of the claim that complainant was offered a choice following the incorporation of MGHDC into MGHDH. Complainant however, insists that respondent simply informed her about an agreement she had to sign to transfer her shares to MGHDH.

F. ISSUES

[18] The issues to be decided are:

18.1 Whether the respondent gave advice to the complainant;

18.2 Whether in so doing, respondent acted in a manner which was not in compliance with the FAIS Act and the General Code of Conduct ('the Code') and / or negligently;

18.3 If it is found that the respondent's conduct did not comply with the provisions of the Act and/or was negligent, whether it caused the complainant to suffer damage or financial prejudice;

18.4 The amount of such damage or financial prejudice.

Whether the Respondent gave advice to the complainant

[19] The respondent is adamant that he acted as an employee of MGH when he offered the MGHDC preference shares to the complainant. He further adds that he did not give advice to the complainant and such, was not bound by the provisions of the FAIS Act.

[20] Advice is defined as follows in section 1 of the FAIS Act.

"advice" 'means, subject to subsection (3) any recommendation, guidance or proposal of a financial nature furnished, by any means or medium, to any client or group of clients -

- a) in respect of the purchase of any financial product; or
- b) in respect of the investment in any financial product; or
- c)
- d)irrespective of whether or not such advice-
 - (i) is furnished in the course of or is incidental to financial planning in connection with the affairs of the client;.....⁷

[21] Whether or not advice was in fact furnished should be established by examining the facts of this case.

Undisputed facts

[22] When the respondent first met the complainant, he worked as a financial advisor at Vulcan. Shortly after meeting the complainant in 2001, the respondent advised her to invest R620 000 in a five year Liberty endowment (no. 1786025). Complainant obtained several financial products on the advice of the respondent. When the respondent left the employ of Vulcan in 2003, he started his own brokerage, Johan Kunneke Brokers.

[23] In November 2004, after informing complainant that he was running his own business, respondent assisted the complainant with the premature surrender of her Liberty endowment (no. 1786025)⁷. The proceeds of the endowment were used to purchase MGHDC preference shares. Prior to purchasing the preference shares, the respondent handed her a document titled, Disclosure by

⁷ The respondent signed the application to surrender the endowment as the complainant's representative.

Broker to Client ('disclosure letter'). The letter contains *inter alia* the following information:

'To all my valid clients:

My name is Johan Kunneke

I am an independent broker

*I am the principle member of **JOHAN KUNNEKE BROKERS** – (Sole proprietor 01/02/2003)*

I have contractual relationship and authorization to sell the following products covered by my letters of authority from the following insurers:

*Altrisk, Discovery, Fmi, Liberty, Metropolitan, Momentum, Sharemax, **MGH development Corporation.** (own emphasis)*

I am not an associated company of any insurer.

My experience is as Follows:

I started my career in 1999 as a Consultant AT Vulcan Financial Services....., I was promoted to Branch Manager in 2002, where I managed 15 consultants, and I was responsible for training and development of the Vulcan Group in insurance products.....I became a Broker in February 2003 to be able to provide my clients with a larger spectrum of products and services.

I have indemnity insurance.'

[24] Given these undisputed facts, respondent's denial that he advised the complainant to invest in MGHDC must fail. The claim that respondent acted as an employee of MGH when he offered the MGHDC preference shares to the complainant must also fail as Respondent's own disclosure letter supports this conclusion as he is described therein as a financial services provider who is authorised to market MGHDC. The letter makes no reference to respondent being an employee of MGH.

Whether the respondent acted in a manner which is not in compliance with the FAIS Act and the Code and/or negligently

Licensing

[25] According to the respondent's disclosure letter which was furnished to complainant, Johan Kunneke Brokers was established on 01 February 2003. The respondent describes himself as an independent broker who offers financial products to the public. As a provider of financial services, the respondent was required by Section 7 of the FAIS Act to have obtained a licence to render financial services from the Registrar.

[26] It emerged from enquiries by the Office that the Respondent applied to the Registrar on 31 July 2004 to render advice and intermediary services. The Registrar confirmed that the license was granted on 15 June 2005⁸. The Registrar further confirmed that the license issued to the respondent does not

⁸ In terms of a generic exemption published on 23 September 2004 in Government Gazette nr 23820 (Board Notice 94/2004) applicants could continue to render financial services as long as they have submitted their FSP license applications. Such rendering of services could continue until the applicant was informed of the outcome of the application. If it was successful, the rendering of financial services could continue but not under the exemption, rather under the approved license.

authorise him to market shares. In other words, the respondent acted unlawfully when he advised the complainant to purchase preference shares of MGHDC.

Appropriateness of advice

[27] It is common cause that the capital invested in the Liberty endowment (no.1786025) was meant to fund the complainant's retirement needs. Given this dependency, complainant could not afford to lose her capital. At the time that she was advised to invest in MGHDC complainant worked as a merchandiser for a retail store from which she earned a meagre salary with no retirement benefits. Although the complainant receives a monthly annuity of R6 200 from her late husband's pension, she indicated to the Office that it is insufficient to sustain her retirement needs.

[28] The complainant's highest level of education is standard eight. Respondent has provided no information to demonstrate that complainant was experienced in financial products, in particular with unlisted securities. It must therefore be assumed that complainant is a lay and inexperienced investor who would have been entirely reliant on the respondent for suitable advice. It is clear from the complainant's particular circumstances that she neither has the appetite nor the capacity to take the high risk associated with unlisted securities with her capital.

[29] So dependant was complainant on respondent that when she was advised to surrender her Liberty endowment (no. 1786025), which was her only means of diversifying her investment, she did not have means to question the respondent. She went with the recommendation and invested the proceeds in shares of a single unlisted company. As an experienced financial advisor,

respondent ought to know the high risk that is associated with investing in a single company. Although diversification is not necessarily a guarantee against loss, it is an important component of reaching long term financial goals, while minimizing non-systemic risk. The aim is to invest in various assets so that they will not all be affected the same way by market events.⁹

[30] By investing the bulk of her capital in a single unlisted company, the risk faced by the complainant increased exponentially. Unlike listed companies, unlisted companies do not have to meet listing standards such as having minimum amounts of capital. Unlisted companies' disclosure requirements are less stringent compared to listed securities and their affairs are not open to public scrutiny. As there is no formal market for these securities, there may be little or no liquidity in unlisted securities. This could enhance the volatility of the share price and make it difficult to sell the securities at a later date.¹⁰ All of this should not be construed to mean private equities have no place in the investment world. They have, but private equities are not for the unsophisticated.

[31] Given the complainant's circumstances and aversion to risk, the advice to invest in a high risk investment such as MGHDC was inappropriate.

⁹ www.investopedia.com

¹⁰ <https://www.fsb.co.za/Departments/capitalMarkets/Documents/Guidelines%20for%20Investors.pdf>

G. Did respondent's conduct occasion the financial prejudice or damage complained of?

[32] Respondent contends that after the initial sale of shares in MGHDC, complainant dealt directly with MGHDC. When the complainant decided to convert her MGHDC shares to MGHDH, he was neither her advisor, nor part of this transaction.

[33] Documentation provided to this Office by the respondent, contradicts his version. When the complainant wanted to make withdrawals from her investment, she faxed requests to the respondents. Respondent would then forward the requests to MHG. When MGHDC was incorporated into MGHDH, it was the respondent who faxed the subscription agreement from his brokerage to the complainant to be signed. Shortly thereafter, MGH sent complainant a MGHDH share certificate with a message that it replaced her MGHDC share certificate. There is no evidence that complainant was ever offered an option to take cash and invest the rest of her funds in MGHDC as alleged by the respondent. It is clear that the transaction to switch shares was merely imposed on the complainant. In any event, when the initial investment was made in MGHDC on the advice of the respondent, the complainant's capital was by that time exposed to excessive and unnecessary risk.

[34] The respondent sold unlisted shares to the complainant whilst not being licensed to do so and also misrepresented to her that he held indemnity insurance. Following enquiries by the Office, the respondent readily admitted that he had never had sight of the financial statements of MGHDC's or MGHDH. He furnished no evidence of due diligence he had conducted on the two entities.

By not conducting proper due diligence on the mentioned entities, the respondent failed to discharge the duty of care he owed to the complainant. Respondent failed to act in complainant's interest.¹¹

[35] The respondent could not provide any evidence of his compliance with the FAIS Act or the Code. In an attempt to evade responsibilities incumbent on him in terms of the Act and the Code, he argued that he did not act as the complainant's financial adviser when he marketed the MGHDC preference shares to her. An argument that has already been dealt with and dismissed.

H. QUANTUM

[36] The Office established that MGDHD was finally liquidated. It is safe to say that complainant lost her capital. Had it not been for the respondent's inappropriate advice, complainant's funds would not have been exposed to risk. Respondent has not disputed that the balance of complainant's funds following the withdrawals of R180 000 is R300 000.

I. ORDER

[37] In the premises the following order is made:

1. The complaint is upheld;
2. Respondent is hereby ordered to pay to complainant the amount of R300 000;

¹¹ See Section 2 of the Code.

3. Interest at the rate of 9 % per annum, seven (7) days from the date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 3rd OF SEPTEMBER 2014.

A handwritten signature in black ink, consisting of a large, loopy initial 'N' followed by a cursive name, all enclosed within a large, hand-drawn oval.

NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS