

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

CASE NUMBER: FAIS 03984/09-10/EC1

In the matter between:-

CHRISTOFFEL ANDRIES SCHUTTE

Complainant

and

R & S WALSH INVESTMENT CONSULTANTS CC

1st Respondent

RONALD WALSH

2nd Respondent

GUY ROBERT COLEMAN

3rd 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 Christoffel Andries Schutte, a 69-year-old male, retiree of Port Elizabeth, Eastern Cape Province.

[2] First Respondent is R& S Walsh Investment Consultants CC, a close corporation (registration number CK 1991/32249/23), duly incorporated in

terms of South African law, with its principal place of business at 38 Upper Street, Central, Port Elizabeth 6001. At all material times, first respondent was an authorised financial services provider in terms of the FAIS Act, with license number 12946. The license was issued on 13 October 2004. It lapsed on 12 February 2010.

[3] Second respondent is Ronald Walsh, a male of adult age, an authorised representative and key individual of the first respondent. For convenience, and where appropriate, I refer to 1st and 2nd respondents collectively as respondent.

[4] Third respondent is Guy Robert Coleman ('Coleman'), a male of adult age, an authorised representative and key individual of the first respondent at the time the financial service was rendered.

B. INTRODUCTION

[5] The complaint relates to inappropriate advice provided by the respondents to the complainant to switch funds from what used to be relatively conservative portfolios to aggressive and risky portfolios while knowing that complainant, being dependent on the funds, needed to make monthly withdrawals. As a result of the risky nature of the portfolios into which complainant's funds were invested, he lost a substantial portion of his investment. He seeks relief from this Office on the basis that in rendering the financial services, respondents acted inappropriately and in violation of the FAIS Act.

C. COMPLAINT

[6] Complainant had a long standing relationship with the second respondent. Their relationship dates back to the early eighties. During 2007, complainant and respondent had occasion to meet about complainant's investments. During or about May 2008, second respondent, sent the 3rd respondent to complainant's home in order to assist him with his investments. Complainant mentions several visits by the 3rd respondent to his home. On one occasion, complainant was asked to sign a number of forms which contained blank spaces. The forms were then taken to the 1st respondent's office for the 2nd respondent's final say. According to the papers furnished to this Office the investment switches were effected on 29 May 2008.

[7] Complainant contends that although he is a terminally ill pensioner, his funds were switched to very highly risky portfolios exposing his investment to severe market shocks he could not tolerate. He further states that the investments comprised the sum total of his savings.

[8] A few months after the investment was made, the complainant perused investment statements received from Sanlam and realised that his investment had diminished in value. He enquired from Coleman whether the investments should be changed. Allegedly, Coleman responded to this by stating that the 2nd respondent believed in taking a long term view when investing and that the market would recover.

[9] A further concern raised by complainant is that at the time Coleman asked him to sign forms at his home, he specifically asked that they do not make any drastic changes that could affect the safety of his personal investment plan

(no. 1370154) and living annuity (no. 1353226). He later discovered the two plans had been switched to risky portfolios. When he asked Coleman why the two plans were changed, he was informed that he had consented to the switches.

[10] Later after Walsh and Coleman had parted ways, he was visited by Coleman. Upon requesting that Coleman explain their actions, he was advised that Coleman acted on the instructions of 2nd respondent

[11] Complainant alleges that he approached 2nd respondent to enquire about his investment and to request his investment file. Second respondent allegedly informed the complainant that he closed his business and had since joined another financial services provider known as, Independent Portfolio Managers (Pty) Ltd. ('IPMG') The complainant was also informed by 2nd respondent that a representative of IPMG, Linda Woodhead was complainant's new financial advisor.

[12] According to the complainant, he approached Linda and requested her to look at his investment file as the investment lost considerable value. During September 2009, Linda switched his investments back to more conservative portfolios. By the time that Linda switched complainant back to conservative portfolios, his total investment value had dropped by approximately R570 000. This amount represents about a 57% drop in investment value in a space of 12 months.

[13] According to the complainant it is as a result of the respondent's actions that he has suffered a substantial financial loss. Consequently, he has had to sell his immovable property and has difficulty funding his medical costs.

D. THE RELIEF SOUGHT

[14] The complainant has asked that respondents compensate him for the damage he has suffered as a result of their actions, which, complainant states, were in violation of the FAIS Act.

E. COLEMAN'S VERSION

[15] Coleman was employed at 1st respondent as an administrator in 2002. His position changed around 2007, when he was appointed as a key individual and partner.

- a. According to Coleman, the 2nd respondent was in charge of clients' portfolios and asset allocation. Second respondent's approach to investments was that they had to be long term;
- b. After an initial meeting between himself, the 2nd respondent and the complainant, he was asked by the 2nd respondent to meet the complainant in order to complete the relevant compliance documents. Coleman states that at the time he did not advise the complainant on the funds that eventually replaced his original portfolio. The reason for this was that although the complainant's market experience, risk profile and other information were recorded on the documents completed by him, it was the 2nd respondent who interpreted the documents and determined portfolios' asset allocation in respect of all clients of the

firm. Coleman was later asked to obtain complainant's signatures to effect the portfolio switches.

- c. Coleman confirms that the complainant had been a client of the 2nd respondent for many years. Initially, he had requested the 2nd respondent's services on the basis that his investments were not performing well, citing insufficient income and capital depletion.
- d. Subsequent to resignation from the 1st respondent, Coleman contacted the complainant sometime in August 2009. This was when he was told by the complainant that he had problems with his investment. Coleman informed the complainant that he had never agreed to the asset allocation in the first place. He advised the complainant to contact the Office to lodge a complaint.

F. FIRST AND SECOND RESPONDENTS' VERSION

[16] According to the respondent, the complainant's investments were taken over from his previous broker and then switched to another portfolio. This was based on the complainant's risk profile of 'Moderately Aggressive' and his investment 'timeline of 10-15 years'.

[17] A comparison was compiled on a spreadsheet using the complainant's investment prior to the switch and comparing it to the forecasted figures of the funds chosen. Long-term performance figures of all funds were used to do the comparison. The comparison reflected that the complainant would be significantly better off after the recommended switch.

- [18] Investment performance figures obtained from the Morning Star justified the belief that the returns of complainant's portfolio prior to the switch would not have kept up with inflation.
- [19] Respondent refutes the statement that complainant signed blank forms. He states that it was unlikely that Coleman would have conducted himself in such a manner, as such conduct would be contrary to the company policy and impact his license.
- [20] Respondent adds that notwithstanding that Coleman was no longer employed by the 1st respondent, he was then a key individual and the representative that called on the complainant throughout the process.
- [21] The risk profile questionnaire reflects an investment horizon of '10+ years whilst another section of the compliance documents states that the complainant wished to invest for '+15 years'. Neither is indicative of a terminally ill man, claims respondent.
- [22] The compliance documents confirm that the complainant understood that unit trust prices could fluctuate strongly and that he was not reliant on the funds. Further to this, the compliance documents confirm that the complainant wanted as much long term growth as possible from his investments.
- [23] Respondent asserts that unit trusts are long-term investments and it was assumed from the complainant's risk profile that he understood this. He adds that complainant stated on his risk profile questionnaire that he was 'knowledgeable and experienced in market highs and lows'.

[24] As can be seen from the Glacier switch forms, 'the complainant agreed to switch units in his Sanlam investments. Subsequent to the investment, respondent sent a letter to the complainant informing him of the switches. Respondent asks, 'if the complainant was not in agreement, why then did he not say something immediately?'

[25] Respondent believes that the complainant spoke to Coleman after his employment was terminated with the 1st respondent. He believes that Coleman implied improper behaviour in the way that the complainant's investments were handled.

G. ISSUES

[26] There are three issues here:-

- a. Whether respondents acted in a manner which is not in compliance with the FAIS Act;
- b. Should it be found that the respondents' conduct was not in compliance with the FAIS Act, whether it caused the complainant to suffer damage or financial prejudice; and
- c. The amount of such damage or financial prejudice.

H. DETERMINATION

[27] Coleman in his response neither refutes that he rendered financial services to complainant nor that the advice was inappropriate. The crux of his defence is

that he acted on the instructions of the 2nd respondent who determined the fund allocation.

[28] Second respondent on the other hand admits to having made the allocation but avers that such allocation and the accompanying switches were based on the complainant's risk profile of 'Moderately Aggressive' with a '10-15 years' timeline. He suggests that the documents were completed by Coleman with the complainant. Additionally he justifies the switch on the long term performance figures of all the funds, stating that the complainant's prior portfolio would not have kept pace with inflation resulting in capital erosion.

[29] Given that the complaint centres on the inappropriate advice which saw the complainant's retirement funds being exposed to high risk, it is perhaps appropriate to consider the actual switches themselves prior to analysing the papers requested from the 2nd respondent and Coleman.

[30] According to Sanlam, the investments were switched on 29 May 2008 as follows:

Personal Portfolio Investment (001370154) – unit trust portfolio¹

Switched from:

Nedgroup Optimal Income Fund	R59 892.16
Glacier FS Conservative M-Manager Fund	R232 965.77
Coronation Absolute Fund	<u>R216 171.98</u>

¹ Unit trusts purchased from of a linked investment service provider ('LISP')

Total	R509 029.91
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Switched to:

Stanlib Resources Fund	R178 160.47
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Stanlib Value Fund	R152 708.97
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Stanlib Nation Builder	<u>R178 160.47</u>
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Total	R509 029.91
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Personal Portfolio Life Annuity (001353226) – Compulsory Annuity

Switched from:

Glacier FS Conservative M-Manager Fund	R501 566.61
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Switched to:

Stanlib Resources Fund	R175 413.66
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Stanlib Value Fund	R150 354.56
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Stanlib Nation Builder	<u>R175 413.66</u>
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Total	R501 181.88
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[31] An examination of the relevant fund fact sheets evidences a conservative portfolio in the case of the Compulsory Annuity, and a moderately conservative profile in the case of unit trust portfolio The Resources, Value

and Nation Builder funds into which the investments were transferred are aggressive funds which exposed complainant to market fluctuations. Such a material change requires compliance with all disclosures and record keeping requirements.

[32] In this respect both Coleman and Walsh were requested to provide their full version of events as well as copies of their complete file of papers relating to this complainant. The compliance documents provided, comprised what is termed a 'Unit Trust Compliance (Needs Analysis) To Financial Advisory and Intermediary Services Bill And Financial Intelligence Centre Act' ('needs analysis'), a 'Risk Profile Analyser' and 'Client Advice Record' allegedly completed by Coleman before the investments were switched.

[33] The document is blank in crucial areas. While the risk profile reflects the complainant as moderately aggressive, which in itself contrasts with the aggressive nature of the investment, there appears to have been no attempt to explain the contradiction between the complainant answering that he requires access to his funds 'All the time' and his supposed willingness to tolerate market fluctuation .

[34] The complainant is credited as being 'Knowledgeable & experienced in market highs & lows' without providing any basis to such conclusion. The complainant was previously employed as a foreman at his brother's amusement park. His highest level of education is a standard 6.

[35] In response to the statement 'I would like to get as much long-term growth from my investment portfolios as possible, even if it means **dramatic ups & downs** (*my emphasis*) on a year to year basis in my investment returns,' the

complainant ticks the 'Strongly Agree' box. Yet there is not a single document evidencing that the complainant was alerted to the real implications of such a statement or the potential conflict with his requirement to access funds on a regular basis.

[36] Quite simply, the need to withdraw funds during a dramatic downturn both compounds and irreversibly locks in losses unless the income drawn down is either dramatically reduced or stopped entirely. If not, there would be a detrimental impact on the very funds which the complainant relied on for his existence in the event the downturn persisted.

[37] The lack of material disclosures is glaringly apparent in the advice record. The record contains different headings and subheadings (i.e. 'Action' and 'Comment') and required the advisor to indicate whether compliance requirements in terms of, *inter alia* the General Code of Conduct ('the Code') were adhered to. One of the headings refers to recommendations as well as Action and Comment as subheadings. The Actions in respect of recommendation are listed as:

- 'Products and product suppliers identified,
- Product supplier disclosure discussed with client,
- Explain identified needs to client,
- Discuss with the client in layman's terms what these products are so the client can make an informed decision.'

- [38] This part of the record however, contains neither recommendations nor actions. In fact it is entirely blank yet is still signed by the complainant. This is clearly a contravention of section 7(2) of the code which states 'No provider may in the course of the rendering of a financial service request any client to sign any written or printed form or document unless all details required to be inserted thereon by the client or on behalf of the client have already been inserted'. This Office pointed out to the 2nd respondent that '*the advisor should have explained and documented the reasons for the advice given to the complainant as well as the reasons as to why the products recommended are likely to satisfy the complainant's needs and objectives (section 9 of the General Code of Conduct)*'. In particular the complainant should have been alerted to the risks of the investment as required by section 7(1)(c)(xiii) of the general code. Clearly, none of which occurred.
- [39] Such a record is not only a requirement of the FAIS Act but a crucial means of understanding the reasoning behind a move from conservative and moderately conservative funds to outrightly aggressive funds, a move which, as pointed out to the second respondent, does not even align with the moderately aggressive risk profile reflected on the documentation.
- [40] The needs analysis document evidences a tick box approach which certainly does not provide sufficient information in order to comply with section 8(1)(a) of the Code, which requires that the provider take reasonable steps to seek from the client appropriate and available information'.to enable the provider to provide the client with appropriate advice.'

[41] Despite all of what I would term obvious concerns with the documentation, the 2nd respondent, in his own version, switched the portfolio on the basis of the complainant's risk profile, 10-15 year time line, and long term performance comparison between funds. He also provided the Office with a spread sheet that lists the complainant's 'investment prior to the switch and comparing it to the forecasted figures of the funds chosen...' The basis of the forecasted figures was the extrapolation of historic one-year and five-year performance figures which reflected favourably on the aggressive portfolio. The second respondent contends that this comparison as well as the fact that the complainant's conservative portfolios would not have kept up with inflation justified the switch to aggressive portfolios.

[42] There is a very good reason that the General Code places a duty on providers to communicate to clients that past performance is not necessarily an indication for future performance. This is also confirmed in investment literature. The phrase speaks for itself. In addition, the circumstances of the case involving a pension on a regular income and an aggressive portfolio undermine the requirement to act in the client's interest. There is simply no way that this advice could be deemed appropriate. The complainant's investment, which comprised the majority of his savings, was placed entirely at risk with no attempt to provide a secure income during market downturns.

[43] The indicated 10-15 year time horizon when seen in isolation would normally give an investor time to ride out the troughs but in this instance the investment cannot be seen in the same light. The complainant was highly dependent on withdrawals from the investment. Such withdrawals were taking place on a month to month basis.

[44] Turning to Coleman, who argues that he should not be held liable for any losses suffered by the complainant, in that the switches to the complainant's portfolios were made by the 2nd respondent, who was in charge of clients' investment portfolios. For a number of reasons I am not swayed by this argument. Coleman was not only a key individual but also the primary point of contact with the client. Having willingly assumed this responsibility, he now seeks to diminish his role and divest himself of accountability by shifting the entire blame onto Walsh. Coleman is not as innocent as he argues.

[45] He mentions having completed the compliance documentation at his meeting with the complainant. However, upon further investigation, the complainant provided a copy of an activity note apparently from the 1st respondent and relating to a meeting between Coleman and the complainant on 18th May 2007, which date matches that on the needs analysis and risk profile. In this record, the complainant expressed a desire to receive an income of 10% per annum on the amount which he wished to invest. Coleman is recorded as stating: "This would be possible with a good portfolio of UT and if the client follows our advice."

[46] This clearly evidences his role in rendering the financial service to the complainant. Given that the risk and needs analysis documents were actually completed on that date and the advice record is not only undated but blank in crucial areas there is a very real likelihood that the advice record was similarly completed.

[47] Certainly there is no evidence that Coleman made any attempt to review or update the complainant's information in May 2008, yet, as I have already

elaborated, there are obvious flaws in this documentation. It was Coleman who compiled this documentation. Certainly there is no evidence that he drew the complainant's attention to the implications of the complainant's answers or the risks which then ensued.

I. FINDINGS

[48] That both Coleman and the 2nd respondent rendered advice to the complainant, is accepted in their respective versions. Whilst the 2nd respondent attempted to justify the advice, Coleman attempted to divert attention onto the 2nd respondent.

[49] Neither defence prevails, in that quite simply they both breached section 2 of the Code in failing to render financial services with the requisite due skill, care and diligence leading to the complainant sustaining losses in the market downturn.

[50] The respondents failed to record the basis on which the advice was given to the complainant as well as the financial products recommended with an explanation as to why the products selected were likely to satisfy the complainant's needs and objectives.²

[51] The respondents failed to disclose to the complainant the risks associated with the products into which his funds were invested. As such, the

² See Section 9 of the Code

complainant was not put into a position where he would make an informed decision about the advice given to him.³

[52] The advice to switch from conservative to aggressive investment portfolios was not suitable for the complainant's circumstances.⁴

[53] It is the respondents' actions that occasioned the loss suffered by the complainant.

J. QUANTUM

[54] Sanlam provided the Office with a breakdown of what the complainant's investments value would have been had his portfolios not been switched to the inappropriate portfolios. According to Sanlam's calculation⁵, had the complainant's portfolios not been switched, and assuming identical withdrawals, the complainant would have been better off to the tune of R494 392.42. I therefore intend to make an order in the amount of R494 392.42.

³ See Section 7(1)(c)(xiii) of the Code

⁴ See Section 8(1)(c)

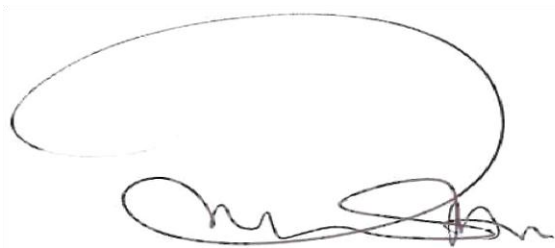
⁵ The calculation takes into account all withdrawals made by the complainant whilst invested in the aggressive portfolios.

K. ORDER

In the premises, the following order is made:

1. The complaint is upheld;
2. Respondents are hereby ordered, jointly and severally, the one paying the other to be absolved, to pay to complainant the amount of R494 392.42.
3. Interest at the rate of 15.5 %, per annum, seven (7) days from date of this order to date of final payment;
4. Respondents are to pay a case fee of R 1000, 00 to this office within 30 days of date of this order.

DATED AT PRETORIA ON THIS THE 17th DAY OF AUGUST 2012.



NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS