IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA **CASE NO: FAIS 04875/14-15/ WC 1**

In the matter between:

GAIL COLLEEN SHEEL **Complainant**

and

MARK ALEXANDER INVESTMENTS CC **First Respondent**

MARK ALEXANDER EISERMAN **Second 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 is a complaint arising from a failed investment made by complainant in the now defunct Relative Value Arbitrage Fund, hereinafter referred to as RVAF, a fund that was managed and operated as a hedge fund - by one Herman Pretorius, (now deceased)- with no license of its own. Complainant's claim against respondent is based on the latter's failure to appropriately disclose the risks involved in investing in the scheme, which complainant was led to believe was a legitimate investment.

[2] Following the death of Herman Pretorius and negative publicity about the fund,

complainant claims respondents, as authorised financial service providers, failed in their duty to appropriately advise complainant and as a result, seeks recourse against respondent for repayment of her invested capital.

[3] In particular, and as a result of the respondents' advice, the complainant invested one million rand in RVAF. RVAF has now been exposed as a Ponzi Scheme, the result whereof being the complainant's funds have been lost.

[4] The quintessence of respondent's response is that they understood that they were dealing with a registered financial services provider. Further that clients were referred to Abante Capital at their request and that Abante provided the advice and explained the risk. In this regard respondent further alleges that all clients were aware that the respondent was not the financial service provider on record in respect of RVAF.

B. THE PARTIES

[5] The complainant is Gail Colleen Sheel (previously Gräbe), an adult female, whose full contact details are on file with the Office.

[6] First respondent is Mark Alexander Investments CC, a close corporation duly registered in accordance with the laws of South Africa with its registered business address being Blandford House, 67 Caledon Street, Somerset West, 7130. First respondent was at all relevant times a licensed Financial Services Provider (FSP nr:692).

[7] Second respondent is Mark Alexander Eiserman, an adult male member, and key individual of the First Respondent who resides at 7 KUNENE, BIEN

DONNE, PINELANDS, 7405.

[8] At all material times hereto, the second respondent rendered advice to complainant whilst acting on behalf of the first respondent. Respondent or Respondents must be read to mean the same person in this determination.

C. THE COMPLAINT

[9] The complaint states as follows:

9.1. In April of 2010, having received a life assurance pay out on the passing of her late husband, the respondent was recommended to her as an investment adviser;

9.2. Having contacted the respondent, it was initially recommended that the funds be placed in a money market account;

9.3. Later in 2010, the respondent recommended that she invest all the funds in the Abante Group's RVAF. The complainant was advised that whilst it was a hedge fund and as such considered a higher risk, this particular fund was on the lower side of the risk spectrum;

9.4. Additionally, other members of her church group had invested in RVAF and the respondent informed her that both he and his family had invested therein. Furthermore she was advised that the fund had consistently provided above average returns, in excess of 20%;

9.5. The respondent advised that there was a gentleman's agreement that the investment be made for 2 years before they could be withdraw. Earlier than that and penalties would be incurred;

9.6. Concerned about investing all her funds in RVAF complainant instead invested R1 000 000 (one million rand), or just over one third of the life assurance proceeds.

9.7. On 29th October 2010 and upon going to the respondents' office to sign the documentation, complainant noticed that it referred to a partnership agreement that she had signed and read. The complainant then queried this with the respondent and requested a copy. The respondent appeared surprised at the request and said that few clients insisted on seeing the complete document;

9.8. Despite this, the complainant proceeded to sign the application form. As requested, the funds were paid into the designated RVAF account, with proof thereof being provided to the respondent;

9.9. As for the partnership agreement, the complainant advises that she again went to the respondent's offices on the 5th November 2010.Initially she was only allowed to read a copy whilst in the respondents' offices, but was able to persuade the respondent to allow her to take it home for the weekend. It was complex and the complainant did not clearly understand the implications, she does not recall any offer of assistance from the respondent;

9.10. This left her uncomfortable and she decided to use another adviser for the balance of the funds;

9.11. With respect to the risk disclosure statement, the complainant states that she does not ever recall seeing or reading this; certainly she was not

given a copy thereof;

9.12. In July 2012 the complainant was invited to a meeting with Pretorius. The complainant was advised by the respondent that he could no longer deal directly with the RVAF. This meeting was held on the 25th July 2012; the following day Pretorius took his own life;

9.13. The complainant contends that at the time of the investment and subsequently thereto, she raised concerns about the investment;

9.14. Having lost her investment the complainant would like the respondent to be held liable for the loss to the maximum of the FAIS Ombud's jurisdiction.

D. RESPONDENTS' REPLY

[10] Before detailing the respondent's reply, it should be noted that this Office has received a number of complaints regarding RVAF. For the most part the key issues are similar if not identical. Accordingly this Office forwarded a notice in terms of section 27(4) of the FAIS Act in respect of the complaint and invited respondent to respond to the complaint by furnishing all documents and any other material that may support respondent's case.

[11] The crux of respondents reply follows:

11.1. Prior to July of 2012 having '*passed all FAIS exams relating to a Category II FSP, which covers succinctly the issues of Administration companies, nominee companies, and holding of client's money in trust. I had no prior knowledge of the legislation nor any insight into possible*

irregularities as compared to the definitions and intention of the legislature at this point in time;'

11.2. In addition thereto the respondent contends that the RVAF structures place it outside the definition of financial products as contained in the FAIS Act, as such, outside the jurisdiction of the FAIS Ombud. In particular the respondent states that the RVAF does not fall within the definition of a financial product as defined in section 1 of the FAIS Act;

11.3. Furthermore the complainant was referred to Abante Capital at her request and it was Abante that provided the advice and explained the risk. All clients were aware of the fact that the respondent was not the financial services provider on RVAF investments and this fact was reiterated by the respondent at a meeting on 24th July 2012 at the Lord Charles Hotel. Mr Pretorius was also present and he satisfactorily addressed questions pertaining to Hedge Funds;

11.4. In amplification of the preceding paragraph the respondent states that following a discussion about hedge funds, the complainant was provided with information about Abante Capital. In order that the complainant investigate them (Abante) and their offerings, the respondent offered to introduce the complainant to Abante Hedge Fund Managers. The complainant then attended a presentation at Abante's offices with Herman Pretorius at which the complainant was advised that as hedge fund managers are not regulated by the FSB. Furthermore they are considered high risk investments;

11.5. The complainant not only attended the presentation but also took home

the full en commandite partnership document for the weekend[1], which contains precise details of the risk that she was taking to invest her funds. The complainant carefully read the Abante documentation which she completed and signed, thereby entering into an En Commandante Partnership agreement;

11.6. The complainant was interested in the fund in that it had historically produced consistent returns. These returns were capitalised within the fund and therefore only subject to capital gains on withdrawal;

11.7. The respondent at all times believed that it was a legitimate business enterprise, as Abante Capital, (previously Management Advisory Trust) was already established in 1993. 'Abante Capital was an approved investment manager with the FSB registered under license nr 874 in 2004. In 2008 the license was transferred to Polus Capital (Pty) Ltd, a company in which Abante had a fair share holding.' The respondent adds that; 'it was common knowledge, at all times, that the FSB had visited the company regularly' and that the FSB had 'investigated Herman Pretorius and Abante in May 2011 and found in essence that he was not doing anything unlawful';

11.8. The respondent makes mention of having visited the trading desk and the fund managers and watched them doing the trades. Mention is made of the various trading strategies;

11.9. The respondent personally considered the RVAF as a suitable

1 This document was provided by the respondent

investment for himself and some of his clients, in that the company had a good long term track record. Further the purpose of a hedge fund was to protect clients against fluctuations of the value of their investment and to achieve a better return than would have been achieved at a bank;

11.10. As to risk disclosure, the respondent states; 'the matter of risk and investment advice was for Abante Capital to address as they were acting as the registered FSP. At no time did I believe that I was acting as FSP or providing intermediary service in relation to the RVAF Fund.'

11.11. The respondent further asserts that at the presentation there was more than sufficient emphasis on risk. In this regard he states; 'approximately 25% of the time was used to explain the risks associated with the investment and how it is controlled and checked. The principle of pairs trading was explained, the investment process, the management of the market risk was all covered in great detail.'

11.12. As to remuneration, the respondent advised that Abante paid a referral fee at a rate of 6.57% excl VAT; which fee was purported to have been financed by the fund manager's profits and not from the client's investment;

11.13. As part of his closing argument the respondent argues that there is a lack of causation. The essence of his argument being that the loss could not have been a reasonably foreseeable consequence of the conduct, which in this instance flowed from a failure by Abante (RVAF) to abide by their obligations.

E. DETERMINATION

Respondents role as adviser

[12] Prior to dealing with the issues common to most RVAF matters, it is necessary that we first deal with the argument that the respondent did not render advice but merely acted as a provider of intermediary services.

[13] This requires that we highlight a number of factors. First and foremost being that at the time of making this substantial investment, the respondent was the complainant's investment adviser.

[14] The complainant was referred to the RVAF presentation by the respondent. This after the respondent raised the subject of hedge funds. There is no indication that the complainant had any knowledge or understanding of RVAF prior thereto. This Office has no information indicating that complainant had ever invested in hedge funds prior to investing in RVAF.

[15] Aside from the actual RVAF presentation and the investment statements, all additional interaction pertaining thereto, both before and after the investment took place directly between the complainant and the respondent.

[16] The RVAF forms were completed, and submitted through the office of the respondent.

[17] To use common parlance within the industry, the respondent owned the client relationship.

[18] The letter of introduction provided to the complainant on the 15th April 2010 states inter alia that:

'IG is accredited to sell most of the commercial investments on

*offer and holds Professional Indemnity Insurance and Fidelity cover. Some local brand names are ……..**Abante Group** (my emphasis)……'*

[19] With regards to Abante; in a document dated the 26th November 2009[2] and provided to the complainant, the respondent stated inter alia:

19.1 *'Thank you for the opportunity to present to you the Relative Value Arbitrage Fund of Abante Capital'*

19.2 *'Abante Capital is an approved investment manager with the Financial Services Board (FSB) It is a member of key hedge fund industry organizations and the management of the company has significant experience in the financial services arena. Please note that hedge funds are not regulated by the FSB in South Africa.'*

19.3 *'The Abante Group won the Hedge fund manager of the year award last year – beating some large competitors. One of the outstanding features of this fund is that it is market neutral. The fund manager's ability to manage the risk is the most important factor to consider. They have a very good record of managing risk. In the hedge fund space this fund would be considered a low risk fund.'*

[20] There can be no question that the respondent both sold and actively promoted Abante/RVAF and in so doing rendered advice. The respondent cannot now attempt to divest itself of the responsibilities that go with the rendering of advice.

2 Appears to be a form of a generic sample letter, possibly intended for a previous client but provided to the complainant for information purposes

[21] In this regard the respondent refers to a referral fee of 6.57%, which the respondent contends was not for the advice or the rendering of intermediary services of a discretionary nature.

[22] By my calculations, this is an amount of R65 700; the actual figure not having been disclosed as required in terms of section 3 (1) (a) (vii) of the Code[3].

[23] The argument that there was no advice rendered to complainant by respondent is unsustainable. The respondent, as the complainant's financial adviser had in terms of section 2 of the Code, a duty of care to '*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'.*

[24] To put it another way, respondent's first priority was to its client. If one were to accept for one moment, that this was only a referral fee, one cannot then escape the question, what drew the client to RVAF. The complaint appears to have had no prior knowledge of hedge funds, or RVAF in particular.

[25] The respondent was involved throughout this entire process, even on his version, accompanying the complainant to the RVAF presentation.

[26] Up and until the collapse of RVAF there was no attempt to break the link between RVAF and the role played by respondent. Only in July of 2012 did the complainant receive an email from the respondent; the relevant sentences whereof reads:

26.1 '*The regulatory environment which governs investment managers has changed and as a result we will no longer be able to assist with*

3 must, as regards all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein and payable to the product supplier or the provider, be reflected in specific monetary terms:..

investments or withdrawals on any investment which is not approved by the regulator. The Relative value Arbitrage fund is a private hedge fund and falls into this category. What does this mean for you going forward? The Abante Group has a very capable administration department and they will willingly assist you with further investments or withdrawals……...You are still welcome to seek our opinion on any investment in which you may have an interest. You will just need to action any such investment decision yourself, where we are not directly managing those investments. '

[27] In light of the preceding paragraphs this again confirms that there is absolutely no question that the probabilities favour the complainant's version that the respondent recommended that she make this investment. At an absolute minimum there was a '*recommendation, guidance or proposal ….which led to the investment.'* [4]

[28] The complainant's funds had initially, on the advice of respondent been placed in the Allan Gray Money Market fund. The applicable amount was then moved out of this investment into RVAF. For the complainant to have moved, what to her would have been an extremely large sum without consulting with the respondent, is unlikely in the extreme. This would also tie in with the admitted discussion around hedge funds, and subsequent arrangement to attend the RVAF presentation.

[29] Yet nowhere is there a record of advice as required by section 9 of the Code.

'*A provider must…maintain a record of advice furnished to a client as*

4 Section 1 of the FAIS Act, definition of advice.

contemplated in section 8, which record must reflect the basis on which the advice was given..'

[30] The replacement of the Allan Gray Money Market fund also required that; *'where the financial product ('the replacement product') is to replace an existing financial product wholly or partially ('the terminated product') held by the client, fully disclose to the client the actual and potential financial implications, costs and consequences of such a replacement…..'*[5]

[31] Despite the requirements of the section mentioned in paragraph 38, no such replacement advice record is evident within the respondents' papers. None of this is surprising given that the respondent does not appear to have conducted '*an analysis, for purposes of the advice, based on the information obtained.'*[6] In fact, in a letter from the respondent dated the 21st May 2013, the complainant is provided with a needs analysis document to complete.

Commonality with other RVAF matters

[32] It is noted that the main concerns regarding investments in RVAF were comprehensively dealt with in the determination of Inch vs Calitz[7], (Inch) where this Office dealt with the key issues. Principally these issues pertain to the respondent's failure to understand the entity (RVAF), and the risks to which respondent was exposing their clients whilst advising them to invest in RVAF.

5 Section 8 (1) (d) of the Code
6 Section 8 (1) (b) of the Code
7 Graig Stewart Inch v Impact Financial Consultants cc and Michal Johannes Calitz, FAIS 0497/12-13/MP1

Thus, the findings in the Inch determination apply to this case *mutatis mutandis*.

[33] As with Inch, an identical set of key questions were put to respondent by means of a notice in terms of section 27(4) of the FAIS Act.

[34] Key to being able to answer these questions is an understanding of the legal requirements governing the rendering of advice, in particular in respect of a hedge fund. Accordingly it is appropriate that I commence with those.

[35] The Registrar of Financial Service Providers, in Board notice 89 of 2007 defined a hedge fund FSP as follows:

‘‘**Hedge fund FSP**’ means a financial services provider-

(a) that renders intermediary services of a discretionary nature in relation to a particular hedge fund or fund of hedge funds in connection with a **particular financial product** (own emphasis) referred to in the definition of ‘administrative FSP’ in subsection 2.1 of section 2 of Chapter 1 of this Schedule; and

(b) acting for that purpose specifically in accordance with the provisions of the respective codes set out in this Chapter III of this Schedule read with the Act, the General Code of Conduct for Authorised Financial Services Providers, 2002 (where applicable), and any other applicable law;’

[36] RVAF was promoted and sold as a hedge fund. The fund itself not only exercised complete control over client’s monies, but additionally itself, carried out all administrative/intermediary services. In this regard I note that the fund statements were on the letterhead of ‘RVAF Trust IT 932/2004’. There was no separate licensed administrator. Accordingly the RVAF fund, as it purported

to operate, fell squarely within the above definition. As will now be demonstrated there are legal requirements that flow from this conduct.

Authorisation to conduct business as a financial services provider

[37] I commence with section 7(1) of the FAIS Act which requires that; 'With effect from a date determined by the Minister by notice in the Gazette, a person may not act or offer to act as a financial services provider unless such person has been issued with a license under section 8.'

[38] In terms of section 7(3) an authorised financial services provider may only conduct financial services related business with a person rendering financial services if that person has, where lawfully required, been issued with a license for the rendering of such financial services.

[39] Neither Pretorius nor the RVAF itself was licensed in any way. There was thus a clear contravention of section 7(1), which led to respondents' contravention of section 7(3) in conducting financial services related business with a person not so authorised.

[40] Yet section 8 (8) (b) of the FAIS Act requires that a licensee must ensure that a reference to the fact that such a license is held is contained in all business documentation, advertisements and other promotional material. Neither that of Polus Capital, nor Abante, nor any other license was displayed in any documentation provided to this Office. This despite respondents' version as already mentioned being that 'Abante Capital was an approved investment manager with the FSB registered under license nr 874 in 2004. In 2008 the license was transferred to Polus Capital (Pty) Ltd. Given the definition of a

'Hedge fund FSP'; for this version to have any credibility one would expect to see the requisite FSP numbers and applicable supporting documentation.

[41] That this did not tie up should have immediately alerted respondent to the fact that they should make further enquiries. There is no evidence that this occurred and accordingly such conduct is indicative of respondent's ignorance of the basic legislative requirements.

Relevant information required to be provided within the product providers documentation.

[42] In order to ensure a client's understanding of the provider with which they are contracting, section 4 of the General Code requires, *inter alia*, that full particulars of the following requirements be provided in writing by the provider:

42.1. Section 4(1) (a) 'Name, physical location, and postal and telephone contact details of the product supplier;'

42.2. Section 4(1) (b) (i) 'the contractual relationship with the product supplier (if any), and whether the provider has contractual relationships with other product suppliers;'

42.3. Section 4(1) (c) 'the existence of any conditions or restrictions imposed by the product supplier with regard to the type of financial products or services that may be provided or rendered by the provider;'

42.4. Section 4(1) (b) (ii) 'names and contact details of the relevant compliance and complaints departments of the product supplier;'

42.5. Section 4 (1) (d) 'Where applicable, the fact that the provider-

(i) directly or indirectly holds more than 10% of the relevant product supplier's shares, or has any equivalent substantial financial interest in the product supplier;

(ii) during the preceding 12 months received more than 30% of the total remuneration, including commission, from the product supplier, and the provider must convey any changes thereafter in regard to such information at the earliest opportunity to the client.'

[43] In spite of the clear requirements of section 4, there does not appear to be any contractual documentation on file which properly complies with these requirements. Nowhere is Polus Capital or Abante Capital as respondent claims; part of this contractual arrangement. It is impossible to be certain as to exactly who the product provider is, as required in terms of this section, let alone the additional details required therein.

[44] The three page application form headed '*DEED OF ADHERENCE FOR INVESTORS WISHING TO BECOME LIMITED PARTNERS OF OR MAKE FURTHER INVESTMENTS IN THE RELATIVE VALUE ARBITRAGE FUND EN COMMANDITE PARTNERSHIP'* does not contain any RVAF contact details.

[45] Whilst on the subject of the application form, I note that whilst it refers to a partnership agreement, the actual document provided by the respondent is headed, 'Investment Management Agreement.' It is a management agreement between 'Relative Arbitrage Management (Proprietary) Limited,' being the investment manager as represented by Herman Pretorius, and the 'Relative Value Arbitrage Fund En Commandite Partnership,' being the fund.

[46] In simple terms the fund made available all its assets, to be managed by the investment manager; the same investment manager who in turn controlled the partnership agreement as the general partner. This was no arm's length transaction. There was nobody to safeguard the investors' funds. The respondent should have communicated this to the complainant.

[47] The fund itself is defined within this agreement as '*an en commandite partnership between Relative Arbitrage Management (Proprietary) Limited as general partner, and Relative Value Arbitrage Fund En Commandite Partnership, as the limited partner.'*

[48] Returning now to the missing contact details; the first document that contains any mention thereof appears to be the acknowledgment of investment dated the 5th November 2010. This is signed off by 'Eduard Brand for and on behalf of RVAF EN COMMANDITE PARTNERSHIP'

[49] These same details are included in the investment statements which then followed. These were headed RVAF Trust IT 932/2004. Quite how the trust fitted in, is not evident from the documentation on file.

Necessary contractual documentation or mandate required to enter into an agreement with a hedge fund.

[50] Additionally sections 5 and 8A of the Discretionary FSP's Code which relate to the mandates and duties of hedge fund FSP's, detail the necessary documents to enter into an agreement with a hedge fund service provider and, despite these requirements, there is not a single mention of Polus Capital or Abante in any such documentation.

[51] For example, section 8A (3) requires that: A hedge fund FSP must, after having complied with subsection 8A (2) with the introductory provisions of subsection 5.1 and with subsection 5.2, and before rendering any intermediary services to the client, obtain an additional signed mandate from the client, in accordance with the proviso to the introductory provisions of subsection 5.1 and subsection 5.2, which apply with the necessary changes.

[52] Subsection 5.1 is particularly important in that it requires a signed mandate which records the arrangements made between the parties, whilst setting out necessary details to be contained therein.

[53] For example section 5.1 (a) authorises the discretionary FSP to act on behalf of the client, and indicating whether the authorisation is given with full or specific limited mandate.

[54] *Section 5.1 (d) thereof requires that the agreement must 'stipulate in whose name the financial products are to be registered and whether they are, for example, to be registered in the name of-*

(i) The client or a nominee company nominated by the client;

(ii) The nominee company of the discretionary FSP or a nominee company within the group of the companies of which the discretionary FSP forms part;

(iii) The nominee company of a product supplier;

(iv) ……;'

[55] Nowhere is there a signed mandate in compliance with section 5 and certainly,

not with Polus Capital or Abante. I particularly point out that the mandate is required to deal with the client's investment objectives; which not only need to be contained in this document but again confirmed in terms of the requirements of the section dealt with hereunder. The lack of a nominee company is also conspicuously absent.

The requirement that there be an additional signed mandate confirming the contents of the first.

[56] Following on from the requirements of section 5(1) we have section 8A (4) which requires an additional mandate from the client which must confirm that the client-

(a) approves of—

(i) the clients investment objectives, guidelines and trading philosophy of the hedge fund FSP, as disclosed and stated in the mandate;

utilisation by the hedge fund FSP of the process to be implemented in the form of strategies or positions (including leverage and/or net short positions, borrowing limits and risk management principles to be applied to mitigate interest rate, liquidity, and credit and derivative risk), risk profile and risk management (for instance a sensitivity analysis), as disclosed and stated in the mandate;

[57] What is clearly evident from a reading of the Code is that that the legislature has made every effort to require not only that the client be appropriately apprised as to the risks inherent in, and processes and strategies followed by the hedge fund, but importantly that the client actually confirms such

disclosure having taken place.

[58] Having examined the documentation, this Office is satisfied that nowhere is any mention made of either the client's investment objectives or her approval of the guidelines and trading philosophy of the hedge fund in the manner as required in terms of section 8A (4).

Written disclosure of hedge fund risks

[59] Now section 8A (4) is further reinforced by section 8A (2) which requires that a hedge fund FSP must before rendering any intermediary services to a client that requires such intermediary services in respect of a financial product governed by the Act, provide a written disclosure to the client in the format determined by the registrar, of the risks involved in a hedge fund. Section 8A (2)(b), specifically requires written confirmation of receipt of such written disclosure.

[60] The format as determined by the registrar is contained within the Notice on Hedge Fund FSP disclosures, 2008 as promulgated in Board Notice 571 of 14th July 2008. This notice requires not only the disclosure of all risks involved in investing in a particular hedge fund portfolio, but, moreover specifies that hedge fund FSP's must ensure that clients understand the risk disclosures.

[61] Respondent has provided no evidence that this board notice was actually complied with, in particular that the client actually understood the risks. The complainant denies having received a copy of the risk disclosure.

[62] The code itself and in terms of section 7 (1) (c) (xiii) further requires that the

provider provide information about:

'any material investment or other risks associated with the product, including any risk of loss of any capital amount(s) invested due to market fluctuations'

[63] Nowhere is there any evidence that the complainant was made aware of the fact that by investing in a hedge fund she potentially placed her entire capital at risk. This risk, itself being magnified by what appears to have been a complete and utter disregard for basic corporate governance, never mind of course the contraventions of the legislation.

Nominee Account

[64] An example thereof being the manner in which and without any mention of a nominee company and in contravention of section 8[8] of the Discretionary Code, monies were directly paid over to, and controlled by, RVAF. In fact, without any supporting agreement or client mandate containing limits on the manner or method of investment, the RVAF exercised complete discretionary control over a client's funds. In simple terms, and as already mentioned there was no separate distinction between the fund manager and the administrative functions. The requirement that the investment be held by a nominee account is a safety mechanism to distinguish investors' funds from those of the service provider. A failure to ensure that the investment is secured by a nominee account as it occurred here robs the investors of this protection and potentially, allows the product provider to use the funds for their own ends. This is a clear breach of the Discretionary Code.

8 Section 8 requires that a nominee company be utilised by the discretionary FSP with the main object of being the registered holder and custodian of the investments of clients.

General duty of an adviser to render advice with due skill, care and diligence in terms of section 2 of the General Code of Conduct for Authorised Service Providers and Representatives, (the Code)

[65] This leads onto section 2 of the General Code; a provision which can be seen to draw together the more specific sections of the General and Discretionary codes. Section 2 of the General Code requires that '*a provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of the clients and the integrity of the financial services industry*.'

[66] Of relevance to this matter, I would expect that the respondent be sufficiently skilled, such that they diligently ensure that they invest their client's money in a reputable entity. To put it another way, that they look after the interests of their client by checking that the fund is actually what it purports to be. From what follows it will become evident that the respondent failed in this regard.

[67] Respondent was specifically questioned on the due diligence which they conducted on RVAF which led to them deeming RVAF to be a suitable investment for their client. In reply thereto respondent made mention of inter alia the license of Abante/ Polus Capital. It is important to note that respondent has chosen to be vague in its response. At no point do they deal with the glaring lack of documentation amongst which is the fact that whilst on complainant's version, Abante was the licensed FSP, there is not so much as a single scrap of paper on file supporting such assertions. There is no evidence of an enquiry with the regulator as to the license status of RVAF.

[68] Mention is made of the respondent having visited the trading desk and the fund managers and watched them doing the trades, yet no mention is made of the complete lack of any financials or even something as basic as a fund fact sheet[9].

[69] This Office has seen no evidence in respondent's papers that the legal meaning of a 'partner e*n commandite*' (own italics) was explained to complainant. Nor is there evidence indicating that respondent disclosed the legal consequences of investing in this entity as a partner. Respondent has further failed to provide a basis for selecting this type of contractual arrangement as an appropriate mode to address the client's needs. This despite the provisions of section 7(1) (a) of the general code which requires that the provider 'provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transactions to a client… Alongside which there is section 7 (1) (b) which requires that the provider whenever possible provide to the client any material contractual information…..'.

[70] It should also be pointed out that of additional concern is the fact that the bank details utilised are those of 'RVAF Trust'. A trust is an entirely different legal entity from a partnership and yet complainant's proof of payment reflects payment into this Trust. Again, respondents saw no need to explain their actions to complainant in this regard. At this point, it is reasonable to conclude that respondents were themselves ignorant of the legal implications.

9 Usually a one to two page document containing important key information about the fund, namely asset allocation, market performance, top holdings as well as the fund management company

F. CONCLUSION

[71] As mentioned previously, this complaint is about being advised to invest in a scheme that was not above board.

[72] The scheme itself purported to act as a legitimate hedge fund; a fact which would have made it subject to the provisions already detailed within this determination.

[73] Yet respondents either ignored, or were unaware of the legislative requirements. Instead they appear to have blindly accepted whatever they were told about RVAF without any proper attempt to verify such information; which information they then recklessly conveyed to their client. The simple fact is that respondents were out of their depth.

[74] Therefore they could have had no understanding about the economic activity that generated the returns, or the sustainability of the investment.

[75] Accordingly the respondents could not have properly apprised the complainant as to the material investment or other risks associated with the product, as required in terms of section 7 (1) (c) (xii) of the general code.

[76] That respondents failed in their duties in this regard is clear. Without Complainant being advised that they were investing in an unregulated and unregistered entity without so much as a set of financials it cannot be said that Complainant made an informed choice as required by section 8 (2) of the general code.

[77] In a nutshell, respondents as registered financial services providers failed to meet the requisite requirements as set out in the FAIS Act.

[78] In many ways the matter at hand mirrors that of the case of *Durr vs ABSA Bank Ltd and Another 1997 (3) SA 448 (SCA),* wherein the Supreme Court of Appeal had occasion to consider the duties of a broker. At 463 the following is instructive:

"The important issue is that even if the adviser himself does not have the personal competence to make the enquiries, I believe it is incumbent upon him to harness whatever resources are available to him or if necessary to ask for professional, legal or accounting opinion before committing his client's funds to such an investment".

[79] In the words of Schutz JA in the above-mentioned Durr matter, at 466 his lordship sounded the following timely warning:

'*One of the first requirements of a professional is to know when he may be getting out of his depth, so that I do not think that that is sufficient excuse. I am not able to say exactly what Stuart should have done. But I would suggest that there was a point at which he should have walked down the passage or across the street, or lifted the telephone, or activated the fax, and said to a lawyer, or accountant, or banker, none of which he was, in the employ of ABSA something like this: 'Look, I have been introduced to some attractive debentures (preference shares) in a group called Supreme. Would you please tell me quite what debentures (preference shares) are and how secure they are. And also, please tell me how I find out who and what Supreme is and what risk attaches to investing in it".*

[80] Similarly, at 468, the words of the learned judge of appeal on what constitutes negligence are instructive. The learned judge pertinently stated the following:

"I come towards my conclusion on the subject of negligence. The basic rule is stated by Joubert (ed) The Law of South Africa First Reissue vol 8.1 para 94, as follows:

'The reasonable person has no special skills and lack of skill or knowledge is not per say negligence. It is, however, negligent to engage voluntarily in any potentially dangerous activity unless one has the skill and knowledge usually associated with the proper discharge of the duties connected with such activity."

[81] Quite simply, no adviser would have recommended this product as a suitable component of any investment portfolio had they so exercised the required due skill care and diligence (section 2 of the General Code). Complainant as a client of a registered financial adviser relied on Respondent's advice when making this investment. When rendering financial services to clients, the FSP is required to act in accordance with the FAIS Act. Respondent failed in this regard.

[82] For the reasons set out above, complainant's complaint must succeed.

G. ORDER

[83] Accordingly the following order is made:

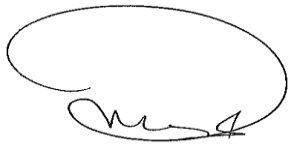
1. The complaint is upheld;

2. The Respondents are hereby ordered, jointly and severally, the one paying the

other to be absolved, to pay to complainant the amount of R800 000.00.

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

DATED AT PRETORIA ON THIS THE 16th DAY OF FEBRUARY 2016.



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NOLUNTU N BAM
OMBUD FOR FINANCIAL SERVICES PROVIDERS