

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

Case Number: FAIS 02511/09-10 WC (1)

In the matter between:-

SERLINA MARIA SMIT

1st Complainant

WILLEM JOHANNES ERASMUS SMIT

2nd Complainant

and

FHJ BELEGGINS EDMS BPK t/a INTEGRO

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] The 1st complainant is Serlina Maria Smit, a female retiree of Bergsig, Worcester. First complainant is married in community of property to 2nd complainant.
- [2] The 2nd complainant is Willem Johannes Erasmus Smit, a male retiree of Bergsig, Worcester.
- [3] The respondent is FHJ Beleggings Edms Bpk t/a Integro (Registration no. 1997/010620/07), a company duly incorporated in terms of South African law,

with its principal place of business at 33 Baring Street, Worcester, 6850. The respondent is also a licensed financial services provider (license number 6020). At all material times hereto, complainants dealt with Helgard Terblanche an employee and representative of respondent. For the purposes of convenience, and where appropriate, I refer to the respondent and Terblanche collectively as respondent.

B. INTRODUCTION

[4] The complaint relates to investments in Dynamic Wealth's MR Property fund ('MRP fund'), made on the advice of the respondent. A few months after making the investments, the complainants noticed a considerable decrease in their investment values. Upon approaching another financial advisor, the complainants learnt that the MRP fund invested in listed property securities which are subject to the vagaries of the market and are therefore considered moderate to high risk. They are aggrieved by the respondent's actions. They claim that he failed to adhere to their instruction - to invest their capital in a safe investment to supplement their small pension. After attempts to resolve the complaint failed, they lodged a complaint with this Office.

C. COMPLAINANTS VERSION

[5] The complainants' complaint may be summarised as follows:

- a. The complainants assert that shortly after inheriting money from 2nd complainant's father, they approached the respondent for investment advice. They could not make ends meet with their small pension and requested the respondent to invest the money in a safe investment to

get extra income. Pursuant to the advice, complainants made the following investments:

1st complainant

MRP fund

10 September 2007 – R200 000

12 March 2008 – R15 000

2ND complainant

MRP fund

20 November 2007 – R60 000

- b. Approximately 6 months after investing, they noticed a drastic decrease in their capital, they approached the respondent for answers. The respondent allegedly denied that the MRF fund was linked to the securities market and assured them that their money was safe. However, another financial advisor informed them that the MRP fund was linked to the securities market and invests in moderate to high risk listed property securities. This meant that there was a possibility that they could suffer losses to their capital.
- c. The complainants assert that the respondent was aware of their circumstances. Second complainant was the breadwinner of the family and retired in 1985 due to ill health. He cannot work anymore. The complainants needed income from their capital invested to supplement their pension of R3 000 per month. They made it clear to the

respondent that they are low risk investors who cannot afford to lose any of their capital. Respondent however, failed to adhere to their instruction to invest in a low risk investment. Furthermore, the respondent failed to consider alternative investments.

D. RELIEF SOUGHT

[6] The complainants want the respondent to compensate them for the financial prejudice they suffered as a result of the conduct of its representative.

E. RESPONDENT'S RESPONSE:

[7] In terms of the Rules on Proceedings of the Office, the complaints were referred to respondent to resolve. The response may be summarised as follows:

a. According to the respondent, 1st complainant met him and sought advice during August 2007 to invest monies that she inherited. The complainant wanted an investment that would provide income as well as capital growth. The investment funds had to be readily accessible to support emergency needs.

b. The respondent asserts that he proposed the MRP fund of Dynamic Wealth to 1st complainant as it provided much better returns than the money market. The MRP fund started in January 2003 and by the end of December 2003 it had yielded a return of 24.03%. For the 3 years that followed the MRP fund yielded the following annual returns:

2004 – 29.64%

2005 – 26.67%

2006 – 23.36%

The respondent contends that the MRP fund had a return of 13.72% for the first 4 months of its life, compared to Sanlam's money market rate of 8.7% per annum.

- c. The respondent further states that he informed 1st complainant that the MRP fund's actual mandate is to yield a return of 15% per annum. Everything in excess would be regarded as a bonus. The product consists of listed property in the commercial and industrial sectors. Anchor tenants with fixed rental agreements and rental escalations protected the value of the property from being eroded. He further told the complainants that there might well be times when returns are negative as is evident from the investment statement.
- d. According to the respondent, it appeared that the complainants were satisfied with the investment as 2nd complainant also requested him during November 2007 to make a further investment of R60 000 in the same MRP fund.

F. DETERMINATION AND REASONS

[8] The issues to be decided are:

- (i) Whether the respondent rendered financial services in compliance with the FAIS Act and or negligently;

(ii) If it is indeed found that the respondent's conduct was in violation of the Act and or negligent, whether such conduct caused the damage complained of;

(iii) The quantum of damage;

The respondent's records

[9] The respondent included in his file of papers *inter alia* a record of advice ('ROA') titled 'MINI ADVIES REKORD/KLIËNTE NOTULE' as well as a Client Mandate (Mandate) titled 'KLIËNTE VERKLARING/MANDAAT'. What follows is pertinent information quoted from the documents:¹

ROA

➤ **Client:** Ms S.M. Smit

➤ **Items discussed:**

Client's Financial situation/needs/goals

Invest R200 000 Dynamic Wealth for capital growth and income

➤ **Advice based on above mentioned** _____

➤ **Recommended change/product and reason** _____

➤ **Decision** **Reason**

Invest in Dynamic Wealth Low risk

Mandate

Investment products

➤ **After a risk analysis was conducted by my broker I consider myself to be a:-**

¹ Translated from Afrikaans

Aggressive investor___ Moderate investor Conservative investor___

➤ **The product provides the following guarantees:**

Low Risk²

Risk profile of MRP fund

[10] The MRP fund invests in property companies listed on the JSE. It follows that the fund is subject to the vagaries of the market. Although property funds are generally regarded moderate to high risk funds, the respondent insists that MRP fund is a low risk investment. The respondent adds that Dynamic Wealth marketed the MRP fund as a low risk fund. Furthermore, the fund fact sheet categorises it as a low risk investment.

[11] On closer scrutiny of the MRP fund fact sheet³ and the fund's marketing material which I'm sure must have been considered by the respondent before recommending the investment, the following is apparent:

- i. The funds asset allocation is
 - Property companies 80%
 - Securities 15%
 - Cash 5%
- ii. The purpose of the fund is to provide **exceptional** capital and income growth at the lowest possible risk (own emphasis)
- iii. The fund's performance
 - 2004 - 24,03%
 - 2005 - 29,64%

² 2nd complainant's ROA contained essentially the same information as that of 1st complainant

³ Fund fact sheet - April 2007

2006 - 23,36%

iv. Liquidity

The M R Property Portfolio is a redeemable fund with no fixed investment term. It should however be regarded as a **long term** investment. (own emphasis)

[12] What would a reasonable FSP conclude from this information? The fund was targeting exceptional capital and income growth - according to the respondent a return of 15% per annum. In principle, such high targeted return would normally imply an investment approach that involved a significant degree of risk. The fund invested 80% in listed property shares and 15% in other listed securities. Listed shares bring significant risk of capital loss and this could be exacerbated if one invested in a limited range of sectors. In the case of complainants, they had invested in one sector, namely, the property sector. It is thus not surprising that Dynamic Wealth regarded the MRP fund as a long term investment. Upon enquiries by this office, Dynamic Wealth confirmed that the risk rating of the MRP fund '...can be considered to be moderate to high relative to the entire asset spectrum of equities, bonds cash, physical property etc.'

[13] I am cognisant that the MRP fund fact sheet lists one of the advantages of the fund as 'Low Risk'. However, given the fund characteristics as set out in para 11, an FSP could not reasonably conclude that the MRP fund is a low risk investment. Moreover, the targeted high return of 15% and the high returns achieved by the fund in 2004 to 2006 do not sit easily with the notion of a conservative or low risk investment. In any event, regardless of the general

categorisation of the fund by Dynamic Wealth, the respondent had the responsibility to make a suitable recommendation and disclose the nature of the risks attendant to the investment accurately to the complainants. I now consider whether the respondent discharged these responsibilities.

Appropriateness of advice

[14] The respondent recommended that complainants invest R215 000 and R60 000 respectively in the MRP fund. At the time the complainants were 61 and 76 years of age, respectively and retired. They lived in a flat on their daughter's property. They did not hold any other investments other than the savings account. The complainants expressed a need **for a safe investment** to supplement their monthly pension of R3 000 per month. They considered themselves **low risk investors**. I have no doubt that respondent had access to this information at the time of advising the complainants.

[15] It is clear from this information that the complainants neither had the capacity nor the willingness to take risk. An FSP presented with this information would have to conclude that the complainants' risk profile is conservative. However, according to the records of the respondent, after the risk analyses were conducted, the complainants were regarded to be moderate investors. Upon being asked to provide the Office with risk or needs analyses reports, respondent failed. He argued:

'As a result of the single needs process, as allowed for in Section 8(4) of the FAIS Act, where the clients did not want a full needs analysis only indicated a single need they identified themselves, the full risk profile was not done. The

clients were however identified as moderate investors as a result of their capital growth needs and signed mandates in this regard acknowledge this.'

[16] The respondent must be referring to Section 8(4) of the Code and not the FAIS Act. Notwithstanding, in terms of Section 8(4) of the Code:

'Where a client –

(a) has not provided all information requested by a provider furnishing advice, as part of the analysis referred to in subsection (1)(b), or where the provider has been unable to conduct such an analysis because in the light of the circumstances surrounding the case, there was not reasonably sufficient time to do so, the provider must fully inform the client thereof and ensure that the client clearly understands that-

(i) a full analysis in respect of the client referred to in subsection (1)(b) could not be undertaken;

(ii) there may be limitations on the appropriateness of the advice provided; and

(iii) the client should take particular care to consider on its own whether the advice is appropriate considering the client's objectives, financial situation and particular needs;'

The respondent's reliance on Section 8(4) of the Code as justification for not conducting an analysis as contemplated in Section 8(1)(b) of the Code is misplaced. This is because he was aware of the complainants' needs and circumstances (as set out in par 14) when the financial services were rendered. He cannot now side-step his obligations to have identified the

financial product or products that would be appropriate to the complainants' risk profile and financial needs.⁴ Had the respondent carefully assessed the complainants' needs and circumstances, as demanded by the Code, he would have immediately recognised that complainants are conservative investors. By investing the complainants' funds into a product which presented risks far in excess of what they could or were willing to take, the respondent contravened Section 2 of the Code. This means he failed to act with due skill, care and diligence and in the interests of his clients.

[17] There is no indication from the respondent's papers that he indeed disclosed the investment risks associated with the MRP fund to the complainants.⁵ Upon enquiries relating to *inter alia* disclosure of risk associated with the MRP fund, the respondent argued that the complainants signed a mandate which states the following⁶:

- The structure and operation of the products were properly explained to me and I understand it
- I understand that there is a direct relation between risk and return.

I am not persuaded by the respondent's argument. These generic statements certainly do not fill that gap for investors such as complainants who would be entirely dependent on an adviser to explain the product and investment risks in a way they understand. The very fact that complainants signed the document means that respondent did not disclose the risk to them. They had

⁴ See Section 8(1)(c) of the Code

⁵ Section 7(1)(c)(xiii) of the Code - as it read before it was amended in 2008

⁶ Translated from Afrikaans

no way of appreciating the risk their capital was exposed to. Had they been made aware of the risk, they would not have invested their funds into MRP.

- [18] Furthermore, the respondent's records do not as is required by Section 9 of the Code reflect the basis on which the advice was given or why the product selected was likely to satisfy the complainants' needs. The respondent's represented to the complainant that the MRP fund is a low risk investment when in fact the investment's risk rating was moderate to high. This was not only a contravention of Section 3(1)(a)(i) and (ii) of the Code, but also Section 8(2) of the Code which required the respondent to take reasonable steps to ensure that the client understands the advice and that the client is in a position to make an informed decision.

Cause of loss

- [19] According to the respondent the complainants' investments were intended to be long term. The loss was caused by them prematurely selling their units in the MRP fund. The respondent also remarked that the price of the units in the MRP fund rose by 8.6% since the complainants sold their units on 30 November 2009.⁷

- [20] The flaw in the respondent's argument is that it ignores the fact the complainants' drew an income from the MRP fund. They had an immediate need to supplement their small pension. As such it cannot be said that they had a long term investment horizon. The need to withdraw funds during inevitable downturns in the securities market compounds and irreversibly locks in losses. The complainants simply did not have the luxury to

⁷ The remark was made in a response from respondent dated 04 May 2010.

dramatically reduce their income until such time that markets recovered. They would also not have known when the markets would recover. I could not find anywhere in the respondent's papers that he warned the complainants about the potential adverse implications market volatility may have when drawing income from an investment.

G. QUANTUM

[21] But for the respondent's failure to discharge his duties in terms of the Code, the complainants would not have invested in the MRP fund. Having considered all of the evidence and arguments, I am satisfied it would be fair and reasonable for the respondent to make good the loss (if any) the complainants have suffered because their money was invested in the MRP fund when it should not have been. I have therefore considered how fair compensation⁸ should be calculated.

[22] In my view it would be equitable to place the complainants in the position they would have been in had it not been for the inappropriate advice of the respondent. According to the complainants' banker ABSA, had the complainants' funds remained in the savings account⁹:

- 1st complainant would have been better off to the tune of R28 125.16
- 2nd complainant would have been better off to the tune of R9 520.98

⁸ See Section 28 (1) (b) (i) of the FAIS Act

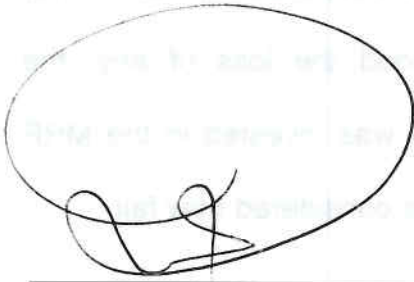
⁹ All withdrawals from the MRP fund were taken into consideration in calculating the losses suffered by complainants.

H. ORDER

In the premises, the following order is made:

1. The complaints are upheld;
2. Respondent is hereby ordered to pay 1st complainant the amount of R28 125.16 and 2nd complainant the amount of R9 520. 98;
3. Interest at the rate of 15.5 %, per annum, seven (7) days from date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 11th DAY OF FEBRUARY 2013.



NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS