IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 07745/10-11/ GP1

In the matter between:

JAMES BRUCE WALLACE	**Complainant**
and	
CS MAKELAARS BK	**First Respondent**
EMILE STORM	**Second Respondent**
MOMENTUM GROUP LTD	**Third Respondent**
IAN MARAIS	**Fourth Respondent**

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

A. INTRODUCTION

[1] Complainant invested an amount of R730 000 – 00 in the Zambezi and Villa property syndications offered by Sharemax Investments (Pty) Ltd, hereinafter known as Sharemax. About a year after making the investment, Sharemax stopped making payments of the promised returns on this investment.

Complainant has since not received any portion of the invested money and considered the whole amount to be lost. He then filed a complaint with this office. The respondents received notices in terms of section 27 of the Act and all four respondents made comprehensive written submissions as to why they cannot be held responsible for complainant's loss. The parties were unable to reach settlement and the matter was then investigated by this office. What follows is the determination arrived at by this office.

B. THE PARTIES

[2] The complainant is James Bruce Wallace (Wallace), an adult male musician and producer of 285 Rooiribbok Street Waterklook Ridge.

[3] First respondent is CS Makelaars BK (CS) a duly registered close corporation and a licensed Financial Services Provider (FSP), having a license number; FSB 9969 of 220 Brenda Avenue, Murrayfield.

[4] Second respondent is Emile Storm (Storm), an adult male FSP and broker of 220 Brenda Avenue Murrayfield. At all material times, Storm acted as a representative for CS.

[5] Third respondent is Ian Marais (Marais) an adult male FSP, who at all material times was employed by fourth respondent at 268 West Avenue Centurion.

[6] Fourth respondent is Momentum Group Ltd (Momentum), a company duly registered and a licensed FSP of 268 West Avenue Centurion.

[7] Wallace made the investment in issue on behalf of his mother, who lives in the UK; he put some of the funds in the investment in his wife's name, Simone Wallace, due to a tax benefit and he also invested R130 000 – 00 of his personal funds. It is not in dispute that Wallace was authorised to represent his mother and his wife and that the two women were actually not directly involved in making the investment. Accordingly, this office does not deem it necessary to join Wallace's mother and wife in this matter although, technically, they have an interest in the outcome of this matter.

C. THE COMPLAINT

[8] During September 2009 Wallace consulted his broker at Momentum about investing his mother's money. His mother, who lives in the United Kingdom, (UK), after having moved there from South Africa the previous year, had one million rand available for investment. The representative at Momentum was Marais, who at all material times, was employed by the latter.

[9] Wallace informed Marais that the available funds did not belong to him, but he had the authority of his mother to invest the money on her behalf. Of significance, Wallace informed Marais that the investment must be made bearing in mind his mother's risk profile. His mother was, at that stage, seventy years old and was looking for capital growth and a monthly income. Marais does not dispute receiving this information.

[10] According to Wallace, Marais introduced an investment offered by a company by the name of “Sharemax”, but advised that he was not authorised to deal with this product. Marais offered to introduce Wallace to Storm of CS. Marais and had accompanied Wallace to meet with Storm. Wallace again explained to Storm that the money belonged to his mother and had to be invested according to her risk profile. This is not disputed by Storm.

[11] Storm, in the presence of Marais, recommended an investment in Sharemax. The recommendation came with the following advice:

a) The risk was low and included monthly income;
b) The investment was in commercial property with a company that had a good track record and good business partners;
c) No commission was payable by the buyer and 100% of the funds will be allocated to the investment;
d) If needed some of the capital can be “drawn”;
e) This investment was widely used by elderly and retired individuals;
f) The investment had capital growth and a good fixed monthly return until the **property was transferred into the investors** name, upon which event they would receive rental income; and capital;
g) The investment was consistent with Wallace’s 70 year old mothers profile and was not considered high risk but moderately conservative.

I point out that when this advice was given, Marais was present; this is not disputed by Marais and Storm.

[12] Wallace then went to the UK and discussed this advice with his mother. Her only concern was about liquidity within the investment. Upon his return to the country, Wallace had another meeting with Storm and Marais where the issue with liquidity was addressed. Wallace was informed by Storm that the investment could be sold within 4 to 6 weeks and also provided for a loan option. Thereafter a risk analysis was completed and once again Wallace raised the risk factor in the recommended investment. In the presence of Marais, Storm informed Wallace that in his opinion this was actually a low risk investment.

[13] On the 19th November 2009, an amount of R730 000 – 00 was deposited into the account of Weavind and Weavind attorneys. Of this money, R600 000 – 00 was Wallace's mother's money and R130 000 – 00 was Wallace's own funds.

[14] Wallace explains that he was advised that the investment to be made was as follows:

"The portfolio was to be split, R400 000 into a no risk savings with Momentum that would remain liquid, the remainder to be invested into Sharemax "the Villa" to preserve capital and produce a dividend, which in turn was to be reinvested into a moderate risk portfolio with momentum."

It is noteworthy that both Marais and Storm do not dispute that they gave this advice.

[15] After Sharemax stopped paying returns, Wallace found out that the company was in financial trouble and had been placed into business rescue. He then consulted

other experts and was informed that the investment in Sharemax property syndication was very high risk.

[16] Wallace's complaint is thus as follows:

a) The respondents, as represented by Marais and Storm, gave inappropriate financial advice;

b) The recommended investment was inconsistent with his mother's and his own financial profile and tolerance for risk;

c) Was not compatible with their need for capital preservation and growth; and

d) The assurance and advice that the investment was low risk was wrongfully given; resulting in loss of all the capital.

e) It follows from this that the complaint entails a breach of the Act and General Code of Conduct for Financial Services Providers (the Code).

f) Wallace wants the respondents to return the lost capital.

[17] Further factual details regarding the complaint will emerge below.

D. RESPONDENTS' RESPONSE

[18] It is convenient for me to deal with all respondents' responses in this paragraph and I will distinguish certain responses that are peculiar to each respondent.

[19] The responses setting out why respondents should not be held liable for Wallace's loss can be summarised as follows:

a) Respondents admit they are bound by the provisions of the Act and Code and submit that they acted according to the provisions of the Act and Code and deny that there was any breach that resulted in Wallace's loss.

b) Marais denies that he introduced or recommended Sharemax to Wallace. Marais' version is that Wallace approached him and enquired about Sharemax. Marais informed Wallace that in terms of his employment with Momentum, he was not authorised to sell the Sharemax product. Marais told Wallace that he knew a broker who was authorised to sell the Sharemax product and proceeded to introduce Wallace to Storm. It is common cause that Marais and Storm knew each other.

c) Storm agrees that Marais introduced Wallace to him and that he was authorised to sell Sharemax investments. Storm's version is that he did not recommend Sharemax to Wallace, but that the latter had made an inquiry about Sharemax.

d) The respondents submit that Wallace made an independent and informed choice to invest in Sharemax and neither Marais nor Storm had advised him to do so. On this basis alone the complaint must be dismissed.

e) Storm provided Wallace with all the available information about the Sharemax "Villa" and "Zambezi" investments. Wallace was handed copies of the respective prospectuses and signed a declaration that it was explained to him and that he understood it.

f) Storm and Marais deny that they had advised Wallace that the investment was low risk. Instead Storm submitted that he told Wallace that the investment was risky.

g) Before the investment in Sharemax was made, both Storm and Marais, independently, carried out a risk analysis for Wallace. This is not in dispute and I will deal with this in more detail below. Notwithstanding the result of the analysis, Storm was of the view that the Sharemax investment fitted Wallace's (and his mother's) needs and risk profile.

h) Marais admits he was present, at all material times, when Storm assisted Wallace with the Sharemax investments. However he was not there to give any advice on these investments. He attended the meetings as a courtesy to Wallace and to see to it that no more of Momentum's business was lost to other products. Marais insists that the decision to invest in Sharemax was made, independently, by Wallace and it was not the result of advice from him and Storm. He also submitted that he did make Wallace, his client, aware of the risks associated with property syndications.

i) Marais submitted that he did not receive any commission in respect of the Sharemax investment. He only received payment of an amount "as a thank you gesture" from Storm, which payment was not disclosed to Wallace.

j) Momentum refer to a written contract between itself and Marais and point out that Marais was prohibited from promoting and selling financial products not approved by themselves. Sharemax was not approved by Momentum. Momentum deny any liability for the consequences of their employee's conduct in this transaction.

k) Momentum states that their advisor, Marais, was not licensed to give advice on the Sharemax product and therefore this office must find that he could not give

any advice in respect of Sharemax. The duty to disclose risk and to keep a record of advice resided with Storm and not with Marais or Momentum. The latter finally submits that Marais did not act outside the ambit of the Act and Code.

l) Marais pointed out that of the one million rand available, R400 000 – 00 was invested, on his advice, in Momentum approved investment products. To this end Marais carried out a risk analysis for Wallace's mother, based on information provided by Wallace.

m) Storm stated that he referred Wallace to Sharemax' s marketing materials where the latter informs that the investment complied with all legal requirements and clients enjoyed full protection and the investment was low risk, delivered good monthly income and capital growth.

n) Storm, through his attorneys applied that this office should determine that it will be appropriate for the matter to be dealt with by a court and that this office decline to entertain the complaint. They submit further that, alternatively, this office should hold an adversarial hearing supported by pleadings and discovery. Further detailed submissions made by Storms attorneys will be dealt with below.

o) Both Marais and Storm state that they complied with their duties in terms of the Act and Code in assisting Wallace with this investment.

E. THE ISSUES

[20] The issues for determination may be summarised as follows:

a) Did Wallace invest in Sharemax as an independent choice with no recommendations from Marais and Storm;

b) In the event that it is found that Marais and Storm did provide financial advice and intermediary services with regard to this investment, did they commit breach of the Act and Code;

c) What are the consequences, in the event that they are found to have breached the Act and Code;

d) What liability, if any, can be attributed to Momentum for the conduct of their employee;

e) Can it be found that Wallace's loss was caused by the actions of Storm and/or Marais;

f) Is it appropriate for this office to entertain this complaint; and are the processes and procedures of this office unfair to Storm and therefore unconstitutional? Should Storm be offered an adversarial hearing?

F. DISPUTES OF FACT

[21] At the outset it is necessary for me to deal with the following issues:

a) As to who recommended the Sharemax product to Wallace. In this regard there is a dispute of fact. Respondents deny that Wallace was advised by Marais and/or Storm to invest in Sharemax.

b) Storm and Marais state that they acted independently of each other and Wallace had been assisted by Storm only after Wallace had already decided to invest in Sharemax. There is a dispute of fact as to whether or not Storm and Marais had collaborated with each other to get Wallace to invest in Sharemax.

c) It will also be convenient for me to deal with the factual issue regarding whether or not Marais received commission in respect of this investment.

[22] Marais stated that Wallace enquired about Sharemax and because he was not authorised to sell this product, informed Wallace that he will introduce him to Storm who was so authorised. Marais created the distinct impression that Storm was brought in only at the request of Wallace.

[23] Wallace flatly called this statement untrue. This is what his response is:

"These statements are not true. During the initial meetings I had with Marais regarding my mother's investments, he on several occasions, at the end of the meetings, raised the topic of a company called Sharemax. He was very enthusiastic about this product and highly recommended that I meet a friend of his, Mr. Storm, who could assist me in this investment. This happened on more than one occasion before I eventually agreed to meet.

I would like to state for the record that I had never heard of the word "Sharemax" before. I certainly would never have requested the investment of my mother's money or mine, into a company I had never heard of, or whose business I did not understand."

[24] Marais also submitted that he had made Wallace aware of property syndication and that it can be dangerous. Wallace replied to this as follows:

"Had he in fact done so, I would never have invested my mother's retirement into this scheme."

[25] Both Momentum and Marais stated that whilst Marais was present at the meetings with Storm and Wallace he did not, at any stage, attend in order to give "legitimacy" to the Sharemax investment. In fact Marais cautioned Wallace about the dangers of investing in property syndication. Wallace's response to this is as follows:

"During the meetings I had with Mr. Storm at which Mr. Marais was also present, at no point did Mr. Marais ever mention being careful about the risks associated with the investment in Sharemax, as stated in the Momentum letter to you. He witnessed all signings of the risk forms on behalf of my mother, and willingly endorsed everything that Mr. Storm was telling me regarding the low risks of the investment."

[26] Wallace did not initially complain about Marais' conduct as he believed that the latter was acting in his interests. With hindsight it became clear to him that Marais and Storm collaborated and that Marais had been lying to him. Wallace concluded that Marais did not act in his interests. All of this is disputed by Marais and Momentum.

[27] In order to resolve these disputes of fact, the following undisputed facts are relevant:

a) Both Marais and Storm were familiar with Sharemax;
b) As an employee of Momentum, Marais was unable to sell the Sharemax product to any client;
c) Marais and Storm were friends or knew each other well;
d) All the respondents claim to be aware of the Act and Code;

e) Marais and Storm admit they knew that investment in property syndication was risky and could not be described as low risk. They do not state that they, as providers, believed that the Sharemax investment was low risk and suitable for pensioners investing their savings.

f) Marais introduced Wallace to Storm and attended all the meetings between them when Storm advised Wallace to invest in Sharemax;

g) Storm admits that Marais called him to go "*on a joint call with him to Mr. Wallace".* It was Marais who told Storm that the client had R600 000 – 00 to invest and Marais provided Storm with an investment statement relating to Wallace;

h) Marais and Storm admit to being with Wallace when meetings took place to assist Wallace with the Sharemax investment;

i) Marais and Storm, independently of one another, conducted a risk analysis for Wallace. Marais classified Wallace as a "*cautious"* investor (*one who seeks capital protection and some growth*) while Storm found him to be a "*moderate"* investor (*one who seeks stability and reasonable growth)*;

j) Marais was present when Storm explained the investment in Sharemax to Wallace and was also present when all the documents were signed with Storm for Wallace to make the investment;

k) The balance of the funds, after the Sharemax investment, were invested on the advice of Marais in a Momentum approved product. The product was classified as conservative and Marais saw this as appropriate for Wallace's financial profile and tolerance for risk;

l) Marais and Storm knew, at all material times, that the available funds belonged to Wallace's mother and were meant to be her retirement money. Both these FSPs were aware that she was unable to replace capital and had no tolerance for risk;

m) Storm gave Wallace a copy of Sharemax' s prospectus and acknowledged that he had explained the contents to Wallace; and

n) Storm had recommended that Wallace invest R400 000 – 00 in Sharemax Zambezi and R330 000 – 00 in Sharemax Villa. Marais was present when this was done.

I will now deal with the disputes of fact in order to make a finding of fact on the following issues:

G. COLLABORATION

[28] There can be no doubt, on Marais' and Storm's own version and on the above undisputed facts that these two FSPs had collaborated on this investment. It is significant that Storm described what they did as "*a joint call"* with Marais. That is exactly what it was and this is supported by their admitted conduct. They joined, not to sell the Momentum product but to sell Sharemax. Marais was prevented by his terms of employment from selling Sharemax and therefore went on a joint call with Storm. If this was not a joint call then there was no need for Marais to be present in all the meetings. Marais' version is that although he was present, he mostly went outside and had coffee on the balcony and did not participate. I reject this version as improbable, why would Marais waste his time if he had no interest

in what Storm and Wallace were doing. Incidentally, both Storm and Wallace contradict this version.

[29] There is no dispute that it was Marais who worked out, with Wallace, how much should be invested in Sharemax. It was also Marais who had instructed Wallace regarding the investment amount.

[30] On Marais' version it was Wallace who asked for Sharemax. Wallace rejects this in the strongest terms and points out that he had never heard of Sharemax until Marais raised the subject. One can test Marais' version. He knew, at all times, as a licensed FSP, that property syndication was a risky investment not suitable for conservative or cautious investors. He also knew that this investment was not within his investment portfolio and was not approved by his employer. Accordingly, at the very mention of Sharemax by Wallace, Marais should have immediately cautioned Wallace and, there and then, washed his hands off the whole thing and should have sent Wallace on his own way. On Marais' own version he did no such thing. He called his friend Storm and asked for a "*joint call".* If Marais was acting in good faith and in the interests of his client, he would have advised Wallace to keep his entire investment within Momentum.

[31] On Storm's version he did not see this transaction as anything other than a joint call between himself and Marais.

[32] Wallace states that when his mother asked him to invest her money, he went directly to Momentum and consulted his broker. It is not disputed that Wallace was an existing client of Momentum and it is entirely probable that he would consult Momentum first. It is highly improbable that Wallace would ask Marais about investing in Sharemax. His profile simply does not support this. Wallace is a musician earning a modest income. He certainly has no history of speculating on the markets, making risky investments to gain higher returns. I reject Marais' and Storm's version that Wallace independently chose to invest his mother's pension in Sharemax. He was persuaded to do so by the joint efforts of Marais and Storm.

[33] Marais made certain that he was present at the meetings with Storm as he knew that Wallace will be comfortable knowing that his Momentum broker was beside him and supportive of the investment.

[34] Well, one may ask, what was in it for Marais? The answer is simple, money. Marais went into this joint call so he could share the commission with Storm. Regarding the commission both Marais and Storm were very coy about the facts. They were both unwilling to make full disclosure to this office and were vague in their responses on this subject.

[35] Storm admitted that he received commission from Sharemax, but failed to disclose how much. He also said nothing, kept silent, about sharing the commission with Marais. It is well known that Sharemax paid lucrative commissions to brokers. They paid 6% of capital upon deposit into Sharemax, (via Weavind and Weavind); the

commission was paid cash up front with no claw back conditions. On this transaction Storm would have received R43 800 – 00 in commission. He certainly split this with Marais but refuses to disclose how much.

[36] As for Marais, he simply lied in his response in this regard. He initially, and unequivocally, stated that he did not receive any commission. He created the impression that he did not receive any financial benefit from this investment. In a further response, he changed his version. This is what he said:

"The broker paid me an amount as a thank you gesture for business. The payment was made 3 months after the Sharemax investment was made. It was paid in a private capacity from the brokers personal account. As the payment happened after the deal as a kind gesture, this was not disclosed to the client."

Notice that Marais fails to disclose how much he received. If indeed he received a nominal amount in appreciation for his referral, he would have disclosed it. Storm does not support this version. In fact he chose to remain silent on the issue of commission.

Marais' version is simply disingenuous and must be rejected. On the probabilities, the payment he received was his share of the commission. He did not disclose this to Wallace nor did he disclose this to Momentum. I must add that it is not to Momentum's credit that they accepted and stood by Marais' version.

[37] In the premises, I make the following findings:

a) Marais introduced and recommended Sharemax to Wallace;

b) Marais advised Wallace to invest in Sharemax as part of Wallace's investment portfolio, which included investments in a Momentum approved product;

c) Marais and Storm collaborated in selling Sharemax to Wallace; and

d) Marais and Storm shared the commission.

H. APPROPRIATENESS OF ADVICE

[38] I now deal with the appropriateness of the advice to invest in Sharemax. Again this paragraph must be read with reference to the undisputed facts set out above in paragraph 27.

[39] Marais and Storm were informed that the R600 000 – 00 belonged to Wallace's mother and formed part of her provision for pension. This lady was 70 years old and both Marais and Storm had to appreciate that she was unable to replace lost capital. It is further not in dispute that Marais and Storm were informed by Wallace that the investment objective or need was for capital preservation with some growth. Wallace also made it clear that he was not going to risk his mother's money in making an investment.

[40] What is significant is that both these FSPs conducted risk analyses in respect of Wallace and his mother. Storm did an analysis in respect of the Sharemax investment and Marais in respect of the balance of the funds to be invested with Momentum.

[41] At the outset, it must be said that the issue of risk was foremost on Wallace's mind as he was sensitive to the fact that he was entrusted with his mother's life savings. It is not in dispute that he informed Marais and Storm about this. I must also accept his version that he only agreed to this investment as he was persuaded by Marais and Storm that the investment was low risk. He was also receiving the assurance of his Momentum broker who was at his side through the whole investment process.

[42] I first deal with CS and Storm:

a) The "Client Advice Record" from CS, filled in by Storm, was provided. The following important information emerges:

- Client needs are recorded as "*Savings, Retirement, Income and Capital growth";*
- Sharemax "The Villa" and Sharemax "Zambezi" is described as the investment. It is recorded that growth will be "12.5%" for The Villa and "12%" for Zambezi "till occupation";
- The term is recorded as "5 year" for both companies;
- The Reason for Policy section records the following, in Storm's writing:

  "*We agree that the investment product is aligned with the investors goals, terms and conditions that needed to be satisfied. <u>This is a low to medium risk investment</u> and must be seen as a 5 year term."* (Emphasis added)
- The reason for selecting the product is recorded as: "*Clients choice".*
- Under general comments client acknowledges the following:

  "2. I am informed that I can lose Capital, when I call up an investment.

3. Original Prospectus of Property Syndication was explained and everything was clear to me.

4. An original prospectus was given to me."

b) This document shows just how reckless Storm was. The document makes it clear that there was a mutual understanding between client and broker that the former was a low risk investor with an investment objective consistent with capital preservation, growth and retirement. Yet the broker's advice is to invest in Sharemax, when, on his own version, Storm knew that this was a high risk investment.

c) The record of advice also shows that Wallace was misled into believing that the Sharemax investment was consistent with his needs and risk profile. He obviously accepted Storm's advice.

d) Wallace acknowledges that he was informed that he can lose Capital "*when I call up an investment".* Clearly this only means that there is risk of loss only when the investment is called up. Wallace had no intention of calling up the investment as it was intended to be long term. He was certainly not acknowledging that he understood this to be a high risk investment with risk of capital loss.

e) Storm also carried out a risk analysis in order to "*help the investor to determine what his/her risk category is".* The analysis took the form of a questionnaire where points were scored based on the answers provided. The result of the analysis, based on Wallace's responses, was a risk profile of "*Moderate"*.

Moderate investor is defined in the document as; "*Moderate investors are long term investors. They need stability and reasonable growth. A certain level of uncertainty can be tolerated, but they want less risk than that of an investment that is a total shares investment."* The Sharemax investment was certainly not compatible with this profile. If Storm had explained the true nature of the Sharemax product to Wallace, the latter would not have, by choice, risked his mother's pension. Storm appears to have ignored the result of his own risk analysis and pushed on with selling this risky product to his client.

f) Under the heading "Prescribed Funds", it is noted by Storm that the amounts being invested in "The Villa" and "Zambezi", total R730 000. Thereafter Storm, in his own writing, notes as follows:

"Client understands this is not market related investments, investment is client choice ***determined by objectives, needs and term****."* (Emphasis added)

It is well documented by Storm that the client's needs and objectives were inconsistent with an investment in property syndication.

g) On the 17th November 2009 Storm carried out and recorded an "Investment Needs Analysis" for Wallace and his Wife. In this document the following is recorded:

- The term of the investment is "10 years or longer";
- The investment objectives are; "capital growth, income and capital must outperform inflation";
- Investment need is stated as: "Saving"; and

- Under the heading “Any additional info regarding the client’s objectives, needs and risk profile?” the following appears in Storm’s own writing:

  “Client confirms that they understand this is an investment into syndicated property throu (sic) Sharemax. The goal is to receive higher returns and capital growth to be reinvested.”

h) Storm also made Wallace complete a form headed; “Sharemax Investments Risk Assessment on Product Information”. The purpose of this document is “to ensure that the investor understands all benefits and risks involved in this investment product”. Then follows a set of questions as follows:

“Did your advisor inform you about the Annual General Meeting where the financial statements will be discussed?

Did your advisor inform you that this product should be seen as a medium to long term investment, meant for an investment horizon of not less than five years?

Do you have a contingency fund for unforeseen expenses?”

Wallace ticked the “yes” option for all three questions.

This document is nothing more than a sham. It does not achieve its own objective of ensuring that the investor understands the risks in the investment. In fact the questions do nothing to assist the client in appreciating the risks in property syndication. The document was signed by Wallace and Storm (as advisor) on the 18th November 2009.

i) Storm also relies on a document setting out the advantages and disadvantages in this investment. It is signed by Wallace and Storm on the 17th November 2009. Under the heading "Disadvantages" the following appears:

"The capital is not guaranteed as in the insurance industry, because it is expensive and that you will limit the growth of your investment"

This statement is entirely misleading. It does not state in plain language that there is a risk that the investor could lose all of the invested capital.

j) It was abundantly clear to Storm, based on his own analysis, that Wallace was an investor with no tolerance for risk. This was his mother's pension savings and there was no possibility that he would put it at even the slightest risk. Certainly, his profile indicated that an investment in property syndication was entirely inappropriate. Storm ignored all of this and recklessly advised Wallace to invest in Sharemax. Storm was focused on his commission and not in the interests of his client.

[43] I now turn to Marais:

a) It must be borne in mind that whilst Wallace was advised to invest in Sharemax, Marais was also advising him, at the same time, to invest the rest of the available funds, R400 000, in a Momentum product. To this end Marais carried out a "risk profiling process" required by Momentum. This consisted of a questionnaire where the answers scored points.

b) This risk analysis determined Wallace's investment risk profile as "*Cautious".* According to Momentum this meant: "*The cautious investor seeks* ***capital protection and some growth."*** (Emphasis added)

Wallace then signed an "Investor declaration" that he should make investments according to the following mandate: "*Cautious".* The declaration is co-signed by Marais in his capacity as Financial Planner.

On Marais' own version, Sharemax was not an appropriate investment for Wallace. He should have strongly advised against it. Ironically, Marais advised Wallace to invest the income from Sharemax in a conservative product.

c) In a Momentum record of advice, filled out by Marais and signed by the parties on the 17th November 2009, the following appears:

- Client's needs, on which the investment is recommended, is recorded as: *"The aim of this investment is to preserve capital and get dividends".*
- In a section recording the financial planner's comments and declaration, Marais writes as follows:

  "We did talk about the portfolios. The Stanlib Dividend Fund is ideal due to dividend being tax free and the fund is ***VERY conservative and according the Risk Profile we need to go cautious. Bruce and me decided to rather go conservative."*** (Emphasis added)

d) On the 17th November 2009, Wallace was still in the process of investing in Sharemax. Clearly Marais was aware of this and must have been aware that Wallace's profile did not fit a risky investment in property syndication. Marais not only failed to give proper advice, he actively encouraged Wallace to invest in Sharemax with Storm well knowing that this was inappropriate.

[44] Of significance is the section 27 (4) letter that was delivered to both Storm and Marais by this office. The following questions were directed at them:

" 11.1. The complaint relates to an investment in the Zambezi Retail Park a property syndication scheme promoted by Sharemax Investments (Pty) Ltd.

11.2. The prospectuses of both the Villa Retail Park Holdings as well as Zambezi Retail Park Holdings declare that the respective entities have never traded prior to the registration of the prospectus, have not made any profit whatsoever and are still under construction.

11.3. In the circumstances how did you expect the income to be paid, other than out of investors' money?

11.4. The prospectuses refer to the investment as being in an ***unsecured subordinated*** *interest rate acknowledgment of debt linked to a share; which share was in an entity still under construction. Additionally the registrar of companies within the prospectus states 'that the shares on offer are unlisted and should be considered as a risk capital investment.'*

11.5. Given the preceding paragraph please advise as to why you considered the investment to be anything less than an extremely risky venture, without any substance to its guarantee on interest payments?

11.6. Was your client properly appraised of these risks? Please provide evidence to this effect.

11.7. What information did you rely on to conclude that this investment is appropriate to your client's risk profile and financial needs? In this regard your attention is drawn to the provisions of section 8 and 9 of the General

Code. (Note: The record we are looking for must have been compiled at the time of advising your client. A post facto account will not be accepted.)

11.8. Should you have acted in a representative capacity in rendering the advice, full details thereof are required, along with any supporting documents?

11.9. We require a copy of your license to demonstrate you were licensed to render financial services to clients in respect of this product."

[45] These questions were never directly answered by Marais and Storm. The latter merely relied on the documents provided by Sharemax, referred to above, and failed to make a direct response to these questions. As for Marais, he merely blamed Storm for the advice and claimed he had nothing to do with the Sharemax investment (a version which I reject). These questions are directed at establishing how, if at all, the respondents directed their minds to making a proper assessment of the Sharemax product and further why they believed it to be appropriate for Wallace. Their silence on these aspects must draw an adverse inference.

[46] I therefore come to the conclusion, based on the above discussion, that:

a) Marais and Storm gave Wallace advice to invest in Sharemax;

b) At all material times, Marais and Storm were aware of the nature of property syndication and that it was regarded as high risk;

c) At all material times, Marais and Storm knew that Wallace was a conservative investor with no tolerance for risk; and

d) Notwithstanding the above, and in contravention of the Act and Code, continued to advise Wallace to invest in Sharemax.

e) Marais and Storm contravened the principles of conduct as set out in section 16 of the Act.

f) Both Marais and Storm failed to provide evidence that they understood how to assess the Sharemax product. A simple appreciation of the convoluted structure the property syndication investment and the risks occasioned by the structure alone, should have led to both dissuading complainant from investing his mother's money in Sharemax.

g) As for Marais, not only did he set up complainant with Storm, he blessed Storm's intervention by ensuring his presence in each consultation.

These providers contravened the following sections of the Code: 2, 3 (a), and 7 and 8 (1).

I. STORM'S ATTORNEYS

[47] After Storm responded to the complaint, he filed a supplementary response compiled by his attorneys. The defenses raised may be summarised as follows:

a) For reasons set out in his declaration, Storm submits that this complaint be dealt with by a court; and that this office should decline to entertain the complaint;

b) Alternatively, Storm and CS be afforded an adversarial hearing before this office using the procedure employed in the high court;

c) There are disputes of fact on essential events and this can only be resolved after hearing oral evidence;

d) The claim of loss is premature as the Sharemax companies are under judicial management and may trade themselves out of trouble. The viability of the scheme is yet to be determined.

e) The process in this office is unconstitutional, for reasons in the declaration;

f) It is inappropriate for this office to deal with “pure delictual claims”.

[48] I must point out the issues raised in 47. (a), (b), (e) and (f) above were dealt with in the Gauteng Provincial Division of the High Court in the matter of:

RISK, DEEB RAYMOND and another vs THE OMBUD FOR FINANCIAL SERVICES and 10 others, Case no 38791/2011.

Judgement was delivered on the 7th September 2012.

The court, under similar factual circumstances dismissed all of these defenses. Accordingly I refer to the judgement and I do not intend dealing with these issues any further.

[49] If this office had to refuse to entertain complaints where there are disputes of fact, then the whole purpose of this office would be defeated. This office can and does resolve disputes of fact, as I have demonstrated above, and the processes in this office were approved in the high court in the Risk judgement. In particular, findings of fact, in this case, were made on the undisputed facts and respondents cannot possibly be prejudiced by a lack of oral evidence. This is a process well established in the high court in motion proceedings. It is also significant that Storm, in his declaration, is vague about what the disputes of fact are. He merely states that

there are significant disputes without stating what they actually entail and why oral evidence is called for.

[50] Storm's attorneys criticize this office for not holding hearings to resolve "material factual disputes". This office does not have a policy that prohibits the holding of hearings. Where it is appropriate, a hearing will be held. In this case there are no material disputes of fact that require such a hearing.

[51] The attorneys cannot make a bald statement that a hearing is necessary. They must set out what evidence is available, that will only emerge from a hearing and which cannot be stated in a declaration or statement. This was not done. Nor do they state what issues of fact require cross-examination.

[52] Additionally, the complaint raised by the complainant centers on the question of appropriateness of advice by the respondents. To this end, the General Code enjoins providers to follow the steps set out in section 8 (1) of the Code prior to advising a client. Once advice has been furnished, it must be recorded in a record of advice in terms of section 9, which record must demonstrate:-

i) the client's identified needs;

ii) product/s considered;

iii) the product/s recommended to the client along with reasons as to why these are likely to suit the client's circumstances.

[53] The code goes further and states that where a client refuses to accept the advice of the provider, the provider must warn the client that the course of action chosen by the client is likely to contradict his interests and record such advice, section 8 (4) (b). Essentially, it is these documents that should be presented to this office in support of respondents' version.

[54] The claim is not premature. Since 2012, Sharemax was placed into business rescue and to date investors received no payments of any kind. Wallace certainly received no payments since the returns stopped. There is no prospect that Wallace will receive any payments and this office can treat the capital as being lost.

J. CAUSATION

[55] Storm's attorneys have raised the issue of factual and legal causation and suggest that this office is incapable of making any findings outside of an adversarial hearing. I disagree with this argument. I now deal with this issue in respect of all the respondents.

[56] The issue for determination is as follows:

a) Whether but for the respondents' advice the complainant would not have lost his funds; this is an issue of factual causation; and

b) If factual causation was established, could the respondents be expected to reasonably foresee that Sharemax will collapse and was there sufficient nexus between the complainant's loss and the advice given by the respondents; this is an issue of legal causation.

[57] On the respondents' own version factual causation was established. But for the respondents' advice, complainant would not have invested in an unknown entity such as Sharemax and his mother's capital would not have been lost.

[58] The issue of legal causation based on the question of indeterminate liability for FSPs for pure economic loss has to be addressed (the remoteness question).

[59] I do not believe that the loss of complainant's funds falls under the realm of delictual "pure economic loss". The respondents' conduct resulted in direct loss of the complainant's capital or property. In this regard see :

Telematrix (Pty) Ltd t/a Matrix Vehicle Tracking v Advertising Standards Authority SA 2006 (1) SA 461 (SCA).

'Pure economic loss' in this context connotes loss that does not arise directly from damage to the plaintiff's person or property but rather in consequence of the negligent act itself, such as a loss of profit, being put to extra expenses or the diminution in the value of property.

In the event that I am incorrect (and I do not concede this) in finding that the complainant's loss is not "pure economic loss"; I deal with legal causation in the paragraphs that follow.

[60] Storm dealt with this question in his declaration. They merely pointed out that it was not reasonably foreseeable that Sharemax will collapse nor is it established what the cause of product failure was. Significantly, the respondents failed to deal with the law and merely relied on a possible factual finding that the Sharemax

collapse was not reasonably foreseeable and that the cause of the collapse is unknown.

[61] Had the respondents carried out the inquiries suggested in paragraph 44 above, they would have realised that this was a risky investment not suitable for the complainant's needs and that there were insufficient safeguards against director misconduct or mismanagement. The test here is not whether or not a collapse, for whatever reason, was foreseeable; but whether or not the investment was appropriate for the complainant, bearing in mind his needs and tolerance for risk including the risk inherent in the investment.

[62] It was clear at the time that the two properties into which complainant's funds were invested were still under construction. A question should have arisen to the respondents as to how a building under construction was able to generate income.

[63] It seems to me that even a question to a financial engineer who is used to dealing with properties would have at least enlightened the respondents about the risks attendant to construction. Thereafter, respondents would have needed to speak to someone who has expertise in valuing unlisted securities to understand both the risks inherent in unlisted securities and how such securities are valued. Better still, an honest statement by Storm communicating Storm's limitations in understanding this product to complainant would have dissuaded complainant from investing in this product. It is telling that Storm simply relied on the papers drawn by Sharemax in communicating the risks involved in this product to complainant. He referred to Sharemax's prospectus, their application form, and not a single source of

necessary and available information that had received independent approval. It is not in dispute that Storm made no reference to having seen and evaluated the group's financial statements. If he did not know how to do so, he ought to have sought help from anyone with expertise in reading financial statements in order to appreciate the financial health of the group. That the two properties were under construction made it more compelling and called for careful consideration and analysis of the source and the viability of the economic activity that would generate such income.

[64] None of these required any extra- ordinary powers of seeing into the future. Storm simply needed to be candid about his abilities.

[65] The enquiry is whether, as a matter of public and legal policy, it is reasonable, fair and just to impose legal responsibility for the consequences that resulted from the conduct of the respondents in giving advice that was inappropriate in terms of the Act and the Code.

[66] It is easy and convenient to impute loss to director mismanagement or other commercial causes. The complainant's loss was not caused by management failure. If the respondents did their work according to the Act and code, no investment in Sharemax would have been made, bearing in mind Wallace's tolerance for risk and the high risk involved in the product. The cause of loss was the inappropriate advice to invest in a high risk product. That the risk actually materialized, for whatever reason, is not the cause of the loss. Otherwise the whole purpose of the Act and Code will be defeated. Every FSP can ignore the Act and

Code in providing services to their clients and hope that the investment does not fail. Then when the risk materializes and loss occurs they can hide behind unforeseeable conduct on the part of product providers. This will fly in the face of public and legal policy and the provisions of the Act and Code.

[67] The reasonable foreseeability test did not require that the precise nature or the exact extent of the loss suffered or the precise manner of the harm occurring should have been reasonably foreseeable for liability to result; it was sufficient if the general nature of the harm suffered by the complainant and the general manner of the harm occurring was reasonably foreseeable. A skilled and responsible FSP, acting according to the Act and the Code, would not have advised complainant to invest in Sharemax. To even suggest that the risk was "Low risk according to the promoters" was reckless. The loss suffered by Wallace as a result of respondents' inappropriate advice was reasonably foreseeable by the respondents. See:

STANDARD CHARTERED BANK OF CANADA v NEDPERM BANK LTD 1994 (4) SA 747 (AD).

[68] It was also held in the above case that:

"as to the issues of loss and causation, that although the untrue report issued by the respondent had been a factual cause of the appellant's loss, the test to be applied to the question whether the furnishing of the untrue report had been linked sufficiently closely or directly to the loss for legal liability to ensue was a flexible one in which factors such as reasonable foreseeability, directness, the absence or

presence of a novus actus interveniens, legal policy, reasonability, fairness and justice all played a part."

It is appropriate to point out that in addition to these factors one has to take into account, in the circumstances of this case, that there is the Act and Code which all FSPs are bound to comply with as well as legal and public policy. All of which, when taken into account in this case, show that there is a sufficiently close connection between the respondents' advice and the loss of complainant's capital. See:

LIVING HANDS (PTY) LTD AND ANOTHER v DITZ AND OTHERS 2013 (2) SA 368 (GSJ)

LEE v MINISTER FOR CORRECTIONAL SERVICES 2013 (2) SA 144 (CC)

STELLENBOSCH FARMERS' WINERY LTD v VLACHOS t/a THE LIQUOR DEN 2001 (3) SA 597 (SCA)

SMIT v ABRAHAMS 1994 (4) SA 1 (A)

ACS Financial Management CC and another vs Coetzee FAIS 00943/10-11/GP.

[69] I accordingly conclude that, based on the peculiar facts of this case, both factual and legal causation has been established.

K. LICENSING

[70] Although Storm was licensed to render financial services in unlisted shares and debentures – categories 1.8 and 1.10, Marais was not.

Marais was also not allowed by his employer to sell Sharemax product as this was not a Momentum approved product. Marais does not dispute that he was not authorised to sell Sharemax, hence his referral to Storm.

L. MOMENTUM

[71] I now deal with Momentum's response to this complaint. At the outset it must be said that Momentum does not dispute that Marais was an employee. They however do dispute liability for his actions. Momentum claim to have carried out their own investigation into Marais' conduct and came to the conclusion that he did not act outside the ambit of the Act. They requested that the complaint be dismissed.

[72] Momentum actually accepted Marais' version that it was Wallace who initiated an inquiry into Sharemax. For reasons set out above, I rejected this version. Momentum accepted Marais' version that he only attended the meetings with Storm at Wallace's convenience. I also notice that Marais gave Momentum a different version, to the one in his responses to this office, that he attended the meetings because Wallace was in a hurry and Marais was simultaneously presenting the Momentum product. This is so improbable that it must be rejected as false. Ironically, if this version was true and Marais was acting simultaneously with Storm, then there was an even stronger duty on him to advise his client of the appropriateness of the Sharemax investment.

[73] Momentum further rely on the terms and conditions of the Financial Planner Agreement between themselves and Marais. I deem it unnecessary to deal with the terms and conditions of this agreement as Momentum cannot rely on this agreement as against an innocent third party. This agreement does not bind Wallace in any way. Momentum may well have to discipline Marais in terms of the agreement.

[74] Momentum submit that because Marais was not authorised nor licensed to sell Sharemax he referred the matter to Storm. Momentum also bizarrely suggest that this office would be forcing Marais to contravene the Act by insisting that he should have advised Wallace not to invest in Sharemax. As a licensed FSP, Marais was under a duty to advise his client that Sharemax was not appropriate for his needs and risk profile. Marais was certainly in breach of the Act and Code.

[75] The difficulty I have with Momentum's submissions is that they failed to see that Marais obviously collaborated with Storm in order to share in the lucrative commission paid by Sharemax. Without the collaboration of Marais, Wallace would not have been persuaded to invest in Sharemax. Marais was aware of the fact that his presence was necessary to persuade Wallace that the Sharemax investment was legitimate and suitable for his needs.

[76] The following is not in dispute:

a) Marais, at all material times, was an employee of Momentum;

b) Wallace was already an existing client of Momentum;

c) Wallace had previously used Momentum for financial services and considered Momentum to be his FSP;

d) When Wallace's mother wanted to invest her savings; Wallace approached Momentum for advice;

e) Momentum was represented by its employee Marais, who gave Wallace financial advice; and

f) Wallace did not approach Marais as an independent broker but as an employee or representative of Momentum.

[77] In the premises Marais, at all material times, and in particular, in advising Wallace, acted within the course and scope of his employment with Momentum.

[78] The issue then, is whether Momentum can be vicariously liable for the conduct of Marais. Vicarious liability means a person may be held liable for the wrongful act or omission of another even though the former did not, strictly speaking, engage in any wrongful conduct. This would arise where there is a particular relationship between those persons, such as employment. As a general rule, an employer is vicariously liable for the wrongful acts or omissions of an employee committed within the course and scope of employment, or whilst the employee was engaged in any activity reasonably incidental to it.

[79] On the facts of this case the following emerges, all of which is not in dispute:

a) Momentum is an FSP and is bound by the Act and Code to act with due care skill and diligence and in the interests of their client. As a representative Marais is bound by same;

b) Marais, as Wallace's advisor, was under a legal duty of care to provide advice that was appropriate for his client's needs and having regard to client's risk profile, in terms of the General Code, section 8;

c) On Marais' own version, he recommended Storm in the process of giving advice as a Momentum employee; and

d) On Marais' own version, he was advising Wallace simultaneously with the advice being given by Storm.

[80] In the premises I make the following findings:

a) Marais' conduct in advising Wallace was expressly authorised by Momentum;

b) His conduct is necessarily incidental to his work as an FSP representing Momentum.

[81] I accept that Marais' advice to invest in Sharemax was not in itself authorised by Momentum and it does amount to a deviation from his contract of employment. However this does not absolve Momentum from liability as Marais' conduct was reasonably incidental to his work with Momentum.

See: **Feldman v Mall 1945 (AD) 733** where the Appellate Division held that: *"Provided the servant is doing his master's work or pursuing his master's ends he is acting within the scope of his employment even if he disobeys his master's instructions as to the manner of doing the work or as to the means by which the end is to be attained."*

In Minister of Police v Rabie 1986 (1) SA 117 (A) at 134 D-E:

A two-tier test was adopted to decide whether an act done by an employee solely for his own interests fell outside the course of his employment.

The test is partially subjective and partially objective.

"First, the subjective intention of the employee had to be considered: did he have the subjective intention of promoting solely his own interests? And, secondly, was there nevertheless ***a sufficiently close link between the employee's act for his own interest and the purposes and business of the employer?*** *The effect was that the employer would escape liability only if the employee had had the subjective intention of promoting solely his own interests and that the employee, objectively speaking, completely disassociated himself from the affairs of his employer when committing the act. The nature and extent of this deviation is critical: once it is such that it could not reasonably be held that the employee was still exercising the functions to which he was appointed, or still carrying out some instruction of his employer, the latter will cease to be liable. Whether that stage has been reached is essentially a question of fact".*

[82] The matter can be tested as follows:

a) First, Marais bore a statutory duty to advise clients with due care skill and diligence. That duty is a duty which also rests on Momentum and Marais was employed to perform that obligation.

b) Secondly in addition to the general duty imposed by the Act and Code, Marais had offered to assist Wallace and he had accepted this offer.

c) And thirdly, the conduct of Marais which caused harm constituted a simultaneous commission with Marais' execution of his duties as an employee of Momentum

In the premises, I conclude that the conduct of Marais, in advising and collaborating in the Sharemax investment, was sufficiently close to his employment with Momentum to render the latter liable.

See:

The Minister of Safety and Security v F (592/09) [2011] ZASCA 3 (22 February 2011)

F v The Minister of Safety and Security [2011] ZACC 37 (15TH August 2011)

M. CONCLUSION

[83] For reasons set out above, I come to the conclusion that this complaint must be upheld.

[84] As a consequence the respondents, jointly and severally, are liable to pay back Complainant's capital in the amount of R730 000.

N. ORDER

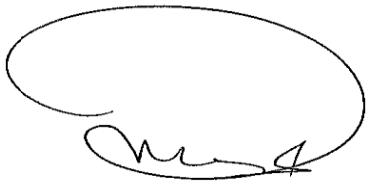
[85] In the premises the following order is made:

1. The complaint is upheld;

2. First to fourth respondents, jointly and severally the one paying the others to be absolved, are ordered to pay to Complainant the amount of R730 000;

3. Interest on the said amount from date of this determination to date of payment at the rate of 10.25% per annum.

DATED AT PRETORIA ON THIS THE 26th DAY OF APRIL 2016.



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