IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA **Case Number: FOC 3690/07-08/FS (5)**

In the matter between:-

PETRUS STEPHANUS WESSELS **Complainant**

and

PIETER DE JAGER MAKELAARS **Respondent**

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

A. PARTIES

[1] Complainant is Mr Petrus Stephanus Wessels ("Wessels"), a 51 year old farmer of Thring Street, Kroonstad 9500.

[2] Respondent is Mr. Pieter de Jager ("De Jager") conducting business as Pieter de Jager Makelaars. De Jager operates under FSP licence 13057. His

principal place of business at 275 Stateway, Jim Fouche Park, Welkom in the Free State.

B. THE BACKGROUND

[3] Wessels met De Jager for the first time in or about the year 2000. De Jager worked in the same office as Wessels' broker at the time. During September 2004, De Jager contacted Wessels to discuss his portfolio of investments. It appears that when Wessels' long standing broker decided to retire, he referred De Jager to Wessels. After gathering information on Wessels' investments, De Jager contacted Wessels to set up a meeting. At the time, Wessels' funds were invested offshore in Old Mutual Guernsey. The portfolio was invested in the following funds:

i. International Managed (USD) – 18%
ii. Fidelity Managed International – 8%
iii. Pacific Stockmarket – 23%
iv. Diversified Plus USD – 51%

[4] At the time, Wessels' original £49 676, 45 invested in November 1999, had reduced to £26 374, 31.

[5] On 22 October 2004, after several meetings, De Jager advised Wessels to disinvest from the Old Mutual Guernsey investment. De Jager further advised

Wessels to invest in forex trading through a company called Leaderguard Spot Forex (LSF). According to Wessels, he was told that the investment had a "20% stop-loss mechanism" which he understood to mean that only 20% of his investment would be "used to do business with" and one could not lose more than 20% of one's capital. I will revert to this aspect later. The investment commenced on 1 December 2004. Wessels invested $23 981, 47.

[6] Thereafter, Wessels met with De Jager to conclude other transactions including an application for life insurance. Sometime between March and May 2005, Wessels read in a newspaper about problems which a company called Leaderguard Securities (LS)[1] was experiencing. He alleges that he did not immediately make the connection between LS and LSF and was under the impression that De Jager would have contacted him if there was a problem. When he received a letter from an entity called Leaderguard Recovery Unit,[2] he immediately approached De Jager. De Jager told Wessels that he was in the process of contacting his clients. They met a few days later and De Jager informed Wessels that the money in LSF had been "stolen." From then until October 2007, De Jager assured Wessels on numerous occasions that investors would get their money back as a result of a claim against KPMG (Mauritius) which was LSF's auditing firm.

[1] Leaderguard Securities SA (Pty) Limited was the marketing arm of LSF.

[2] This body sought to allegedly assist investors to recover money lost in the Leaderguard. I have in a previous determination commented on the Leaderguard Recovery Unit. See *Du Plessis vs Willemse FOC1176/05/GP*.

[7] However, when Wessels read the Leaderguard Liquidator's report dated 19 September 2007, it was clear to him that his investment could not be recovered.

[8] On 18 October 2007, Wessels wrote a letter to De Jager demanding his capital with interest. De Jager however, told Wessels to proceed with his complaint to this Office but pointed out that it was premature in light of the claim against KPMG.

[9] Wessels lodged his complaint with this Office on 9 November 2007.

The relief sought by complainant

[10] Wessels is seeking R285 000, 00 (being the rand value of the investment on 1 December 2004) + "rente gelyk aan die Moratore koers, tans 15.5% per jaar saamgestel, vanaf 1 December 2004 tot en met die datum van vereffening." [Interest equivalent to mora interest which is currently 15.5% a year calculated from 1 December 2004 to date of payment]

Investigation by this Office

[11] The complaint was forwarded to De Jager on 10 March 2008, requesting him to resolve the matter with his client, alternatively to revert with a response to the complaint. The matter could not be resolved between Wessels and De Jager. De Jager filed his initial response on 14 April 2008. A notice in terms of Section 27(4) was issued on 5 September 2008. De Jager filed his

complete file of papers on 26 September 2008. Further documentation was filed on 4 September 2009.

The respondent's version

[12] According to De Jager, he was first introduced to Leaderguard in February/March 2001 by representatives of Hamilton Solutions Limited. At the time, he admits that he thought that the monthly commissions/fees were not sustainable.

[13] In August 2004, a fellow broker introduced him to Mr. Kiep Van der Westhuizen, National Manager and Director of Hamilton Solutions and Mr. Gerhard Erasmus, Free State Manager and Director of Hamilton Solutions. De Jager was shown LSF's Portfolio and their returns. These were compared with the returns on De Jager's client portfolios which were invested with Old Mutual International. De Jager states that the "Leaderguard returns with the 80% capital security were substantially better than those of the [Old Mutual] portfolios." De Jager alleges that Van der Westhuizen and Erasmus indicated that LSF was audited by KPMG and showed good returns. At the time, LSF was in the process of registering with the Financial Services Board.

[14] On the strength of Van der Westhuizen and Erasmus' assurances, De Jager then contacted his existing Old Mutual International clients. De Jager states that he "discussed this additional investment opportunity" with his clients and

the opportunity to diversify the existing offshore portfolios by investing a portion or percentage of the offshore holdings with LSF.

[15] It was at this time that De Jager met with Wessels. According to De Jager, Wessels' broker, who was retiring from the industry, referred him to Wessels. Upon perusal of Wessels' portfolio information, De Jager saw that Wessels was a medium aggressive investor and likewise that his portfolio at Old Mutual Guersney was a moderate aggressive investment.

[16] De Jager also saw that Wessels' investment had devaluated since inception significantly due to the decline on international stock markets. With Wessel's agreement, the full value of the portfolio was therefore transferred to Leaderguard with the primary goal of achieving positive returns. The investment of $23 981, 47 commenced on 1 December 2004.

[17] By this time, De Jager had been appointed as area Manager for Hamiltons Solutions Ltd in the Northern Fee State.

[18] Included in De Jager's managers' remuneration package was an additional 0.2% thus bringing the monthly cost to client to 0.7% per month. De Jager alleges that he had a discussion with a Mr. Chris Viljoen (Free state Representative for Leaderguard Spot Forex/Securities) regarding the fees and requested his own fees to be reduced on all his clients to 0.2%. Viljoen forwarded De Jager's request to Management (Leaderguard) who replied that

the computer systems (calculating fees) cannot be adjusted per individual clients.

[19] De Jager states that he became "more and more uneasy " about the cost to client structure, "even more so when after a Hamilton's meeting in Bloemfontein and informal discussions with brokers longer associated with Hamilton's Solutions learned that Mr. Chris Viljoen earned in excess of a R100 000, 00 per month from his Free State book." [sic]

[20] De Jager was subsequently invited to a lunch appointment early December 2004 by Leaderguard to discuss any questions he had regarding Leaderguard. At this meeting, he learned about the "extravagant approach by the Leaderguard Directors, where a whole resort in Mozambique is booked at a time for as long as two to three weeks and Directors and Management are flown in by Helicopter."

[21] In mid December 2004, while on holiday, De Jager contacted Mr. Tim Hefer of Johannesburg International Commodities Management (JICM)[3] whom he had known since 1998. According to De Jager, the following information was disclosed by Mr. Hefer: [quoted as is]

[3] JICM was a foreign currency-trading investment scheme

- *"that two of the Directors of Leaderguard was previously (1997-1998) employed by JICM as broker consultants but due to reasons (which Mr. Hefer did not disclosed to* [De Jager]*, their contracts was terminated.)*

  The two person then started their own company and according to Mr. Hefer used the JICM platform to manage their client's portfolios. Mr. Hefer later cancelled this arrangement due to further indiscrepancies that come known to Mr. Hefer.
- *The performances quoted by Leaderguard for the 1997 and 1998 year was in fact the returns of JICM and not Leaderguard and most importantly:*
- *In 2002 Leaderguard reported a positive growth of 14.55 % for the calendar year although the industry (FOREX) average was 5-6% negative, including a well known offshore Company with which JICM was affiliated, called Cullinham Asset Mandate headed by a Mr. Richard Cullinham.*

[22] Upon hearing this, De Jager alleges that he immediately instructed his secretaries to contact all his Leaderguard investors in order to affect the sale of their investment. All his investors in Leaderguard signed sale instructions and all were received by Leaderguard by 8 March 2005.

[23] Unfortunately not all his client's funds were withdrawn by the time of Leaderguard's demise on 30 March 2005. Wessels was one of these unfortunate clients.

[24] While De Jager was of the view that he was not liable for the complainant's loss, in an email dated 4 September 2009 De Jager offered to pay Wessels an amount of R2850, 00 on a monthly basis but Wessels has refused the offer.

The issues

[25] The issues to be decided are:

25.1 Whether De Jager had the requisite authority to market forex products;

25.2 Whether De Jager acted in a manner which is not in compliance with the FAIS Act and/or negligently and if so, whether his conduct caused the complainant to suffer damage or financial prejudice; and

25.3 The amount of such damage or financial prejudice.

C. DETERMINATION AND REASONS THEREFORE

[26] The facts surrounding the demise of LSF and the Leaderguard group are well documented in our previous determination in the Comrie matter.[4] There is no need to deal with the detail here save to highlight the following:

[4] *Selwyn Comrie and Another v Ewing Trust company Limited FOC 1807/05/KZN (5)*

26.1 LSF was a private company incorporated in Mauritius. On 29 September 2004 Leaderguard Securities SA (Pty) Limited (LS), the marketing arm of LSF applied for a licence in terms of Section 8 of the FAIS Act. Between this date and 18 April 2005 (when the licence was ultimately refused), LS operated under the Registrar's exemption in terms of Board Notice Number 94. The objective of the exemption was to accommodate late applicants for authorisation in terms of Section 8 of the Act whose applications may not have been finalised as on 30 September 2004, on which the Act became fully operative. The exemption in effect permitted them to carry on with current business activities relating to the rendering of financial services until such finalization of their applications. Where their applications were then finally granted, they would be able to carry on such business activities as licensees under the Act without any further need for an exemption. But in the case of a final refusal of applications, the carrying on of their current business activities as regards the rendering of financial services would have to cease;

26.2 In April 2005 both LS and LSF were placed in liquidation;

26.3 We now deal with the issues of this matter.

Whether De Jager had the requisite authority to market forex products?

[27] Section 7 (1) of the FAIS Act states 'a person may not act or offer to act as a financial services provider unless such person has been issued with a licence…'

[28] Respondent under his FSP licence, 13057 has never had authorisation to provide financial services in respect of "foreign currency denominated investment instruments."

[29] The investment documents which include, application form, Client questionnaire Foreign Exchange Risk Disclosure Notice, General Terms and Conditions and Trading Mandate has both Hamilton Solutions and LSF's logos at the top of each document. It is recorded on the application form that the investor is "introduced by Pieter de Jager" and the "agent" is Chris Viljoen. All the investment documents referred to above are signed by Wessels (as Principal investor) and De Jager (as Advisor).

[30] He alleges that his original licence application included application for authorisation for "foreign currency denominated investment instruments" but he was subsequently advised by his compliance officers, Moonstone, that he did not require such authorisation for the Old Mutual Guernsey investments.

[31] We know from our investigation that consumers who invested in LSF either had to go through LS (LSF's marketing arm) or Hamilton Solutions' ('HS'). Like LS, Hamilton Solutions operated under the Registrar's exemption in terms of Board Notice Number 94 until the date of refusal of its application for authorization i.e. 23 October 2007.

[32] At the time the financial service was rendered De Jager alleges that he acted under Hamilton Solutions FSP in terms of a "co-operation agreement". De Jager is unable to provide a copy of the agreement.

[33] The FSB has already investigated De Jager's allegation. In correspondence with this Office, the FSB said:

> *Pieter de Jager is one of the 210 intermediaries investigated by this Office for assisting clients to place investments either directly with Leaderguard Securities (Pty) Ltd ("Leaderguard") or indirectly via Hamilton Solutions Ltd ("Hamilton"). Hamilton operated an intermediary (broker) network and had a white label agreement with Leaderguard in terms of which all the brokers in the network could market/sell Leaderguard's products directly to their clients. The brokers signed agency agreements with Hamilton and they had to be appointed as its representatives.... In this instance, De Jager was found to have operated under the exemption during the entire period that investments were made after the inception of the FAIS Act. Subsequently, no action was taken against him.*[5]

[5] Correspondence from James Molefe (FSB) dated 3 April 2009

[34] It appears therefore that De Jager was in fact authorised to market forex products and did so under Hamilton Solutions FSP licence, albeit in terms of an exemption granted to Hamilton Solutions.

[35] It is noteworthy that De Jager failed to apply for authorisation under his own FSP licence. It appears that he thought he may have needed such authorisation for the Old Mutual International products but does not mention needing such authorisation for Leaderguard. Presumably he was satisfied to act under the authority given to Hamilton.

Whether De Jager acted in a manner which was not in compliance with the FAIS Act and/or negligently

Appropriateness of advice

[36] Clause 8(1)(c)of the General Code of Conduct provides:

> 'A provider . . . must, prior to providing a client with advice . . . identify the financial product or products that will be appropriate to the client's risk profile and financial needs . . .'.

[37] Amongst the documents filed by the respondent, is a client questionnaire completed by the complainant. [The complainant's answers are underlined.]

Do you understand that values on your investment can increase as well as decrease? YES

What is the purpose of this Investment? CAPITAL GROWTH OVER 3-5 YEARS

What % of risk are you prepared to take on the original Dollar Investment?

0% - 20%

What % of your net assets form part of this Investment? 10% - 30%

Investment Choice MODERATE GROWTH 50% USD AND AGGRESSIVE OPTION 50% USD

[38] In spite of the risk profile reflected in the questions and answers above, Wessels was placed in a higher risk forex trading investment.

[39] An analysis of the Old Mutual International Guernsey investment portfolio reveals that there was a substantially lower risk associated with it as compared with the speculative forex trading of Leaderguard.

[40] As stated by Wessels, he was told by De Jager that only 20% of his money would be traded with and he would therefore not lose more than 20% of his money i.e. 80% of his money would be secure. This is in line with the complainant's stated intentions of taking between 0% and 20% risk on his investment.

[41] However, what Wessels perceived as a guarantee on 80% of his capital was in fact not true.

[42] De Jager failed or neglected to notice a condition stipulated in LSF's document titled 'The General Terms and Conditions' which provides:

> '3. Pre-determined risk mandates and trading styles may change from time to time according to market conditions. **No capital guarantee is offered by LSF and the investor warrants that he/she shall not hold LSF liable for any capital losses suffered by the investor.'** (My emphasis)

[43] Clause 8(2) of the General Code of Conduct provides:

> 'The provider must take reasonable steps to ensure that the client understands the advice and that the client is in a position to make an informed decision.'

[44] I have no doubt that had this been brought to Wessels' attention, he would have not exposed 10% -30% of his net assets to this risk.

[45] In the circumstances it is my view that De Jager's advice was inappropriate and breach of his duties as provider in terms of the Code.

Disclosures

[46] Clause 7(1) of the General Code of Conduct provides:

> Subject to the provisions of this Code, a provider other than a direct marketer, must–
>
> (a) provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision

[47] There is no evidence put forward by the De Jager that the risks associated with speculative forex trading were disclosed to Wessels, apart from Foreign Exchange Risk Disclosure Notice signed by the complainant.

[48] Neither is there evidence that De Jager disclosed to the complainant that none of his capital was guaranteed.

[49] I have mentioned above that De Jager rendered the financial service under Hamilton Solutions' which was operating under an exemption. Having said this, there is no evidence that De Jager disclosed this fact to Wessels. The FAIS Act places a duty on providers to inform the public that they are operating in terms of an exemption, where this is the case.

[50] Clause 5(d) of the General Code of Conduct provides that a provider must disclose the:

> "details of the financial services which the provider is authorised to provide in terms of the relevant licence and of any conditions or restrictions applicable thereto."

[51] De Jager failed to mention to complainant that while LS was operating under an exemption, LSF itself had not been approved by the FSB at the date when the investment in LSF was made.[6] He also did not disclose that he himself was operating under an exemption pending the processing of Hamilton Solutions' licence application. Disclosure of these facts was important. Rejection of either Hamilton Solutions' or LS's licence applications would have meant that any monies invested by his clients during the period of exemption would have had to be refunded to them. Failure to mention this meant that the complainant was not placed in a position to make an informed decision.

Replacement policy advice record

[52] Further non-compliance with the Code is the fact that there is no replacement advice document on record as required by section 8(1)(d) of the Code. Therefore there is no evidence whether any comparison was made between the replaced product and the replacement product. (Risk, costs, etc. should

[6] Leaderguard Spot Forex (Mauritius) was in fact never approved as it did not submit an application. See my determination in *Willem Johannes DeLange and Elma Cornelia De Lange vs Johan Stander Case no: FOC 1109/06-07/EC (5)*, issued 15 October 2009.

have been shown in detail for the complainants to make an informed decision). As stated above, Wessels' funds were switched from Old Mutual Guernsey to Leaderguard. No replacement policy advice record has been furnished by De Jager in support of the switch.

High commissions

[53] As stated above, when De Jager initially heard about Leaderguard, he admits that he felt that the commissions were not sustainable.

[54] In an earlier determination issued by this Office viz. *Mackrory vs Naude* [7]we stated:

> *"the higher than normal commission paid to the intermediaries was also an indicator that should have aroused some suspicion on the part of the Respondent"*

[55] Clause 2 of the General Code of Conduct provides:

> "A provider must at all times 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."

[7] *Michael Denman Mackrory vs Marius Naude CASE NO: FOC 914/05/GP/ (1)* issued 31 May 2006

[56] Despite De Jager's initial view (in 2001) that the commissions were not sustainable, he still moved his clients' funds into Leaderguard.

[57] In my view, De Jager did not display the necessary care and diligence and appears to have been ultimately motivated by the high commissions in spite of his reservations.

CONCLUSION

[58] Based on the above, it is clear that:

58.1 The advice provided by the respondent was not appropriate considering the complainant's stated needs;

58.2 The respondent failed to properly disclose relevant and material information to enable the complainant to make an informed decision - including the risk associated with the investment or the difference in risk between speculative forex trading and the replaced product;

58.3 The respondent failed to disclose that LS and Hamilton Solutions were operating under an exemption;

58.4 The respondent failed to abide by the replacement policy protocol;

58.5 The respondent failed to render the financial services in accordance with the requisite honesty, care and diligence and in the interests of his client.

D. QUANTUM

[59] The dollar value of the investment on 1 December 2004 was $23 981, 47. The complainant is claiming interest on the amount. The respondent has repeatedly urged the complainant to postpone his complaint pending the outcome of the litigation against KPMG. However, it is extremely doubtful, after almost five years since LS and LSF were placed in liquidation, that the complainant would recoup any of his capital from those entities. However, if he does then it stands to reason, if the respondent has in the meantime compensated him for his loss that he would have to reimburse the respondent for any amount that would constitute a double payment to him of his capital and interest. It is left to the parties to enter into an appropriate agreement in this regard when settling the claim.

THE ORDER

I make the following order:

1. The complaint is upheld;

2. The respondent is ordered to pay complainant the amount of $23 981, 47 within fourteen (14) days of the date of this order;

3. Interest on the aforesaid amounts at 15.5 per cent per annum calculated from fourteen (14) days after date of this order to date of payment;

4. The respondent is to pay the case fee of R1 000, 00 to this Office.

Dated at PRETORIA this 12 day of February 2010.

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CHARLES PILLAI

OMBUD FOR FINANCIAL SERVICES PROVIDERS