

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NO: FAIS 04296/12-13/ EC 1

In the matter between:

DAPHNE AURET FOSTER

Complainant

and

VAIDRO 173 CC t/a Vaidro Investments

1st Respondent

ANDREA MOOLMAN

2nd Respondent

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

A. THE PARTIES

[1] The Complainant is the Mrs Daphne Auret Foster, an adult female whose full contact details are on file with the office.

[2] The First respondent is VAIDRO 173 CC t/a Vaidro Investments, a close corporation duly incorporated in terms of South African laws and authorised financial services provider, number FSP 38693, and carrying on business at 42 Elkie Drive, Wilro Park, Roodepoort.

[3] The Second respondent is Andrea Fredericka Moolman, key individual and sole member of First respondent, and who shares the same address as First

respondent. Respondent and respondents must be read to mean the same thing in this determination.

B. THE COMPLAINT

[4] In 2011, complainant invested a combined total of R800 000 in RVAF. The investments were made in consequence of the recommendation and advice of the Second respondent who acted as complainant's financial adviser. The R800 000 was made up as follows:

- 4.1. 1st February 2011- R150 000;
- 4.2. 2nd June 2011- R550 000;
- 4.3. 25th November 2011- R100 000.

[5] The funds were transferred from Mr Foster's (complainant's spouse's) bank account.

[6] The complainant states as follows:

- 6.1. The purpose of the investment was two-fold namely capital growth for an imminent retirement, as well as the access to additional cash in the event of Mr Foster's passing;
- 6.2. As to risk, complainant was advised that RVAF would be less risky than investing in the JSE, in that the risks were better managed. In this regard complainant was advised that whilst the returns in good time would be less, conversely the returns during a downturn would not be as bad. This implies that there was some smoothing effect on the investment returns. In this respect complainant was advised and shown records indicating

not only that the fund had shown good performance over a long period but that it even showed a positive return over the stock exchange crash of 2008;

- 6.3. Asked by the office as to what needs analysis was conducted by respondent, complainant replied, that this was not necessary as the couple had other investments for their pension;
- 6.4. Questioned by the office on what products were offered to her by respondent, complainant advised that she was also offered another hedge fund¹ but advised by the respondent that RVAF was more secure;
- 6.5. A risk assessment was conducted by respondent which indicated RVAF as being suitable to complainant's requirements.
- 6.6. The investment comprised all of complainant's investable capital but constituted 15% of the couples total retirement savings;
- 6.7. The investment was misrepresented, being in fact a Ponzi or fraudulent scheme; accordingly the resulting loss did not arise out of the usual market swings. Accordingly complainant holds respondents accountable.

C. RESPONDENTS' REPLY

[7] As the Office has received a number of complaints regarding the RVAF investment from respondent's clients, all of which presented identical key concerns, similar notices in terms of section 27(4) of the FAIS Act were forwarded to respondents in respect of each complaint. In turn and with the necessary references to individual complainants, respondent provided a comprehensive

1. In the absence of an advice record complainant can no longer recall the details thereof

reply applicable to all its matters before this office.

[8] Commencing first with the aspects pertaining to the specific complainant at hand, respondent had the following to say:

- 8.1. Complainant had been referred to respondent by a relative on or about January 2011;
- 8.2. Complainant's husband wanted to invest in RAAF but wanted to do so in his wife's name (the complainant) for tax purposes. In this respect the record of advice reflects the following; 'you are investing in your wife's name for risk management purposes should your consultancy business be sued';
- 8.3. The husband wished to meet with Pretorius in order to ask several questions. A meeting was arranged after which, the husband expressed his satisfaction with the answers;
- 8.4. Respondent asserts that the husband is a business risk analyst by profession, who specialises in company structures. According to respondent, the husband advised that 'he is well informed and knowledgeable regarding trading shares and any such other structures and that he himself in his own capacity trades Satrix top 40²;'
- 8.5. In this vein respondent also advises that the complainant is knowledgeable about business structures and hence understood that the investment made use of a partnership agreement;
- 8.6. 'No Financial needs analysis was conducted as this was treated as a single need. The complainant required nothing more as he is already well

2. This is a unit trust index tracking fund which electronically tracks the top 40 shares on the JSE. One buys or sells units in the fund, which holds the shares.

invested for retirement;'

8.7 However a risk analysis was completed which reflected complainant as being an aggressive investor;

[9] Respondent kept proper minutes of each meeting, along with a record of advice which was signed by the complainant. This record of advice evidences that the complainant was warned by the respondent about the high risks of the product. The complainant was afforded an opportunity to respond to the response provided by the respondent.

9.1. Complainant's husband was advised to liquidate all his retirement savings and invest them in RVAF. Fortuitously he did not act on this advice;

9.2. 'Mr Foster is not a retired Business Risk Analyst but is a Management Consultant specializing in Lean manufacturing. Mr. and Mrs. Foster are both 'savers' and thus have an interest in investments. We do have investment portfolios managed by Brokers who are qualified and registered with the FSB'.

9.3 They hold a small number of SATRIX 40 shares;

9.4 'The points above have no relevance to the issue at hand; we received poor advice and lost our investment of R800,000 as a result of taking Mrs. Moolman's advice';

9.5 The investment was not made in wife's name for tax purposes, but as originally stated, for the purposes of ensuring that she had access to funds should something happen to Mr Foster;

9.6 'It was expected that the funds were to be **invested and trade** in the top 40 companies on the JSE, that certain measures would be in place to

manage risk....’

[10] Turning now to the documentation provided by the respondent and from which the following was extracted:

- 10.1 The hedge fund risk notice has a paragraph stating; ‘It is further recorded that I am aware that the Financial Advisor does not have specific approval from the Financial Services Board to furnish advice or render services with regards to these types of products. However I understand that this type of investment is increasingly becoming more acceptable as evidenced by the prominent monthly performance reports by Nedcor and Symmetry (both of which are part of the Old Mutual Group);’
- 10.2 The aforementioned document additionally states that the respondent only provided factual information on hedge funds and did not provide advice;
- 10.3 A record of advice reflects that due to the poor returns client wishes to reduce money market holdings and rather invest in a vehicle offering higher returns. The notes go on to state that the client understood both that hedge funds were high risk as well as the manner in which they trade, namely, market neutral and quantitative arbitrage;
- 10.4 Additional minutes state that the reason for the investment is; ‘capital growth and diversification away from money market rates;’
- 10.5 The following is also noted, ‘client accepts this is a high risk hedge fund, with a high return. Trading strategies can reduce market volatility, or increase potential for loss of capital;’ Additional notes refer to the potential of the fund to ‘blow up’ if trading strategies are mismanaged;
- 10.6 There is a further note stating that only a maximum of 20% of funds

should be invested.

[11] Proceeding on to the general response, respondent states that in terms of the record of advice the risks attached to this product are explained in plain language and that the record states that no forms were signed which were not fully completed.

[12] The point is also made that the application forms signed by complainant explain in plain language that the structure of the investment involved becoming a partner in the RVAF.

[13] Specifically questioned as to the due diligence she conducted, respondent advised that having been introduced to Abante Capital she visited the premises where Herman Pretorius explained the strategies and how the risk was managed. Having been introduced to the trading team respondent then proceeded to ascertain whether Abante Capital was registered with the FSB. In addition thereto respondent confirmed with Momentum and Old Mutual and spoke to their fund managers about Abante Capital and their use of the fund in their portfolios.

[14] Respondent goes on to state that having a reasonable knowledge of Hedge Funds respondent concluded that the strategy is sound and when mostly top 40 JSE companies are invested into, this should be a sound fund. According to respondent, Mr Pretorius explained that the way that this fund operated kept the risk relatively low.

[15] Respondent reasons that she was satisfied that persons investing in the fund were fully appreciative and aware of the risks involved, both in that they attended

presentations by Herman Pretorius but also in that respondent further explained the process and operation of the fund as she understood it. In this regard a written explanation of Board Notice 571³ was provided and explained to each client.

[16] As to the basis upon which respondent deemed RVAF to be a suitable basis for her clients' respondent advised as follows:

- 16.1 Many clients need a higher return on their investment to ensure that they reached their investment goals, and as an adviser it was her duty to ensure that all products and all investment avenues are explored on behalf of clients;
- 16.2 Given the various market crisis's hedge funds could both act as a defensive strategy and outperform traditional investments in a downturn;
- 16.3 Researching the different hedge funds available in the country respondents research showed that Abante Capital was one of three hedge funds in South Africa;
- 16.4 In 2008 Abante Capital won a hedge fund award. With regards thereto respondent provided a Symmetry multi manager document showing the market neutral category winner as 'Abante Statistical Arbitrage.'

[17] The portfolio was explained to clients as a hedge fund which invested in shares on the JSE. It was explained that as in any investment involving shares the risk is of a high nature, however historically the loss in downside markets is lessened when hedge trading strategies are used.

3. Hedge Fund FSP Risk Disclosures Notice

[18] In this regard respondent states that Herman Pretorius had explained that hedge funds may actually be a lower risk than traditional investments as the target is to protect capital, increase defensive strategies, and obtain absolute returns under all market conditions.

[19] As to commission respondent advised that this was 7.5% but with no trail commission. This does not appear to have been disclosed to the client as required in terms of section 3.(1) (vii) of the code.

D. DETERMINATION

[20] Reference is made to the determinations of *Inch vs Calitz*⁴ and in particular that of *The Trustees of the Johnnie Pringle Investment Trust vs Vaidro/Moolman*⁵ where this Office dealt with the key issues, which pertain to the rendering of advice to invest in RVAF by respondent. Principally the issues pertain to the respondent's failure to understand the entity, (RVAF) and the risks to which she was exposing her clients whilst advising them to invest therein.

[21] Evident therein are the material deficiencies in the application forms which, as they lack in substance or form it is difficult to understand who or what the complainant was dealing with. Yet in spite of these failings, funds were transferred directly into RVAF without even the protection afforded by a nominee account.

4. Graig Stewart Inch v Impact Financial Consultants CC and Michal Johannes Calitz FAIS 0497/12-13/MP1

5. *The Trustees of the Johnnie Pringle Investment Trust IT1280/2004 v Vaidro 173 CC t/a Vaidro Investments and Andrea Moolman FAIS*

[22] In attempting to support her version, respondent and as part of their investigations into the investment vehicle contends that they were shown an FSP license no 874 in the name of Abante Capital (Pty) Ltd and accordingly they were satisfied that Abante with whom they had an intermediary agreement was correctly licensed. Yet there is not so much as a single mention of Abante or its license number⁶ within the contractual documentation, which points to respondent having failed to understand the contracting entity.

[23] Furthermore there were no financials or even so much as a fund sheet. Respondent claimed that the fund invested in mostly the top 40 companies on the JSE, yet provided no documentation supporting such a belief. Ergo, without the financials or so much as a fund fact sheet respondent could not have understood the economic activity that generated the returns.

[24] Furthermore respondent was unable to explain to the office just why RAAF was nowhere to be found in the very documentation which respondent used in support of recommendations she made to invest in RAAF. I refer here to the Symmetry multi manager South African Hedge Fund Survey which as its name suggests lists numerous hedge funds including those of Abante. RAAF though, is conspicuous by its absence.

[25] The inescapable conclusion is that respondent knew nothing about the fund or its underlying investment and accordingly was in no position to advise her clients to invest in it.

[26] As referred to in both the Inch and Pringle Investment Trust determinations, the

6. section 8 (8) (b) of the FAIS Act requires that a licensee must ensure that a reference to the fact that such a license is held is contained in all business documentation, advertisements and other promotional material

case of *Durr vs ABSA Bank Ltd and Another 1997 (3) SA 448 (SCA)* is instructive.

In this regard the learned judge pertinently stated the following:

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

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

[27] In light of what is stated in the preceding paragraphs respondent has breached section 2 of the General Code which requires that ‘a provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of the clients and the integrity of the financial services industry.’

[28] In this regard the client was in no position to understand the ‘any material investment or other risks associated with the product’ as required by section 7. (1) (c) (xii) of the Cde.

[29] Quite simply the client did not make an informed decision as required by section 8 (2)⁷ of the Code.

[30] No sensible person having been given the correct material information or advice would have invested in RVAF. On information provided by respondent complainants understanding was that RVAF was less risky than investing in the JSE, in that the risks were better managed. This version accords with

7. Section 8 (2) 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.

respondents own reply which inter alia states that the target is to protect capital. Not only was this incorrect but most certainly did make for an informed decision. On the contrary complainant was misinformed.

[31] What complainant needed to know is that RAAF was an unregistered ponzi scheme without so much as a set of financials, fund fact sheet or even a license number on any of its documentation. It is concerns such as this that complainant should have alerted complainant to.

[32] Given what has already been detailed in previous determinations, there is certainly no way the RAAF product would have been appropriate to the complainant's risk profile and circumstances as required by section 8 (1) (c) of the Code. While there is no record evidencing other products that were considered, the reasons for recommending the RAAF product cannot be referenced to the complainant's interests and circumstances. In fact judging from the respondent's records, the complainant would not have had the necessary information to make an informed decision. The fact that the client wanted 'capital growth and diversification away from money market rates' when viewed against the myriad of risks involved in RAAF, all of which complainant could not have known can simply not assist respondent especially when considering the myriad of approved funds with credible records and performance that are available out there. Section 9 (1) (c) requires an explanation as to why the selected is likely to satisfy the client's needs or objectives. Nothing in the records explains why it was necessary to take such a risk with a substantial portion of complainant's capital. That complainant and her husband were nearing retirement and thus unable to replace the funds makes such a recommendation even more questionable.

[33] Now as to respondents' comments on complainant's husband profession or his investment experience which seeks to portray him being an experienced investor, the following is stated: What is not in dispute is that complainant sought guidance of a licensed financial adviser; namely the respondent, for which advice and guidance respondent took an above average commission of 7.5%. In so doing respondent had a duty to ensure that the advice that was provided was correct and appropriate for complainant's circumstances as is demanded by the Code. Other than taking an interest in his own financial affairs there is no evidence that complainant's husband possessed any particular investment knowledge or experience. Had the complainant's husband been the experienced investor the respondent makes him out to be, he would have certainly steered clear of RVAF. Complainant's statement that they sought out and paid for the counsel of investment professionals for their investments has not been gainsaid.

[34] Finally it needs to be stated again that the disclosures as to fees do not appear to have been made in accordance with section 3.(1) (vii) of the code. In particular the amount is not reflected in specific monetary terms.

[35] For the reasons set out above I make the following order:

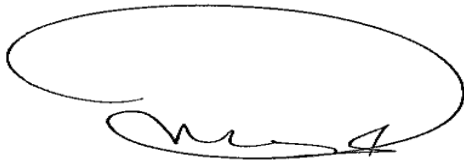
E. ORDER

[36] Accordingly the following order is made:

1. The complaint is upheld;
2. The Respondents are hereby ordered, jointly and severally, the one paying the other to be absolved, to pay to complainant the amount of R800 000.

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

DATED AT PRETORIA ON THIS THE 25th DAY OF MARCH 2015.

A handwritten signature in black ink, enclosed within a hand-drawn oval. The signature is stylized and appears to read 'Noluntu N Bam'.

NOLUNTU N BAM
OMBUD FOR FINANCIAL SERVICES PROVIDERS