IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS PRETORIA

CASE NUMBER: FAIS 00837/13-14/ GP 1

In the matter between:

HELOISE ALETTA STEPHINA JACKSON **Complainant**

and

JOHANN NELL FINANCIAL SERVICES CC **First Respondent**
JOHANN NELL **Second Respondent**

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

A. INTRODUCTION

[1] On 6 April 2013, complainant filed a complaint with the Office against respondent.

[2] The complaint arises from an investment that was made by complainant into Sharemax Liberty Mall Holdings Limited[1]. The basis of the complaint is that respondent advised complainant to invest in a high-risk scheme that was incompatible with her personal circumstances as a pensioner.

[1] Registration number 2007/007383/06

B. THE PARTIES

[3] Complainant is Heloise Aletta Stephina Jackson, an adult female pensioner whose full particulars are on file with the Office.

[4] First respondent is Johan Nell Financial Services CC, registration number 2000/059266/23, a close corporation duly registered in terms of South African laws with its principal place of business situated at 39 Wild Peach Villas, Woodlands Drive, Pinehurst, 7550. First respondent is an authorised financial services provider with license number 7119. The license is still valid.

[5] Second respondent is Johann Nell, an adult male representative and key individual of first respondent whose address is noted in the regulator's records as 39 Wild Peach Villas, Woodlands Drive, Pinehurst, 7550.

[6] At all material times, second respondent rendered financial services to complainant. I refer in this determination to both first and second respondents as respondent. Where necessary, I specify.

C. BACKGROUND TO SHAREMAX

[7] Sharemax Investments (Pty) Ltd (Sharemax) was in the business of promoting public property syndication investments to the public, managing properties and investor funds. The company was incorporated in 1998 and was based in Pretoria.

[8] On 13 September 2005, Sharemax was granted a licence as an Authorised Financial Services Provider in terms of section 8 of the FAIS Act. In terms of the licence, Sharemax was authorised as a Category 1 Financial Services

Provider to render advisory and intermediary services with regard to Securities and Instruments, shares (1.8) and debentures (1.10).

[9] Sharemax issued prospectuses regarding public property syndication investments that it promoted from time to time. These prospectuses were purportedly registered with the Registrar of Companies in terms of section 155 of the Companies Act 61 of 1973.

[10] According to the information contained in the prospectuses, all investments were to be paid to the attorneys and the funds would be retained in an interest-bearing account. In contravention of Government Gazette 28690, Notice number 459 of 2006, which states that funds shall only be withdrawn from the trust account in the event of registration of transfer of the property into the syndication vehicle; funds were withdrawn by Sharemax, some of which were utilised to fund commissions.

[11] Investors were told that they would receive healthy returns in the form of guaranteed income for the first year of the investment term (bar the first month of investment term).

[12] During the course of 2010 various property syndications under Sharemax were experiencing difficulties in paying out the promised income.

[13] Following an inspection conducted during 2010, under section 12 of the South African Reserve Bank Act[2], the Registrar of Banks concluded that Sharemax obtained money by conducting the business of a bank, without being registered

[2] 90 of 1989

as a bank. The subsequent intervention by the Reserve Bank resulted in frozen investments and massive building operations being uncompleted and lying dormant.

[14] Directives were issued to Sharemax for the repayment of funds collected from individual investors in September 2010. The South African Reserve Bank appointed independent fund managers to take control of the assets of Sharemax and its property syndication companies.

[15] During 2012 the court sanctioned schemes of arrangement[3] in respect of several schemes within the Sharemax stable. Several schemes were taken over by Nova Property Group Holdings Limited 2011/003964/06 (Nova) and Sharemax investors were issued with debentures or shares in Nova.

[16] Sharemax's FSP license nevertheless lapsed in October 2012.

[17] A few interesting points to note:

17.1 Around the time of the announcement of the scheme of arrangement in 2011, the executive directors of the erstwhile Sharemax Group, Dominique Haese, Rudi Badenhorst and Dirk Koekemoer held 43.2% of Nova's issued shares and are currently listed as directors of Nova[4].

17.2 The registered address for Nova Property is 105 Club Avenue, Waterkloof Heights, Pretoria, which is the same building as the old Sharemax head office.

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[3] As contemplated by section 311 of the Companies Act 61 of 1973

[4] http://www.frontieram.co.za/AboutUs.aspx

17.3 Frontier provided a range of administrative services to Nova, and Centro Property Group manages the property portfolio on behalf of Nova. The directors of Frontier are D Haese, D R Koekemoer, C J Van Rooyen and R N van Zyl (formerly directors of the erstwhile Sharemax Investments (Pty) (Ltd); and the directors of Centro Property Group are E Grobler and M J Osterloh[5].

17.4 Frontier Asset Management sent out a communique dated 6 August 2013 warning investors that those who brought complaints to the Office of the FAIS Ombud would lose their right to have their Sharemax investments converted into Nova debentures or shares.

D. THE COMPLAINT

[18] On 11 May 2004 complainant invested an amount of R100 000 with Sharemax Comaro Crossing. Comaro Crossing was subsequently sold at a profit and complainant received a cumulative amount of R107 000 following the sale.

[19] During April 2007 respondent presented to complainant the option of transferring her investment (the proceeds of the Comaro Crossing sale) to the Liberty Mall, alternatively, receive the full amount tax free. Complainant, upon advice from respondent, elected to reinvest the full amount in Sharemax Liberty Mall and the transfer was effected during July 2007. The investment was for a period of 5 years. Respondent allegedly advised complainant that it was a good investment.

[5] http://www.frontieram.co.za/AboutUs.aspx

[20] Complainant initially received approximately R600 – R700 from this investment after which interest payments stopped during June 2010. However, following a scheme of arrangement sanctioned during January 2012 payments resumed but ceased once again during May 2012. Despite numerous phone calls to respondent, complainant has been unable to resolve the matter.

[21] Complainant further indicated that she is a pensioner with a sickly husband. Her husband, who had equally lost his life savings as a result of following respondent's advice and invested in Sharemax, had to sell their vehicle in order for them to survive. Complainant made the point that she is in dire need of her capital, as they were now left destitute.

E. RELIEF SOUGHT

[22] Complainant seeks repayment of the amount of R107 000.

[23] The basis of complainant's claim against respondent is the latter's failure to render financial services in line with the FAIS Act and the General Code of Conduct, which includes respondent's failure to appropriately advise complainant and disclose the risk involved in the Sharemax investments.

F. THE RESPONSE

[24] In compliance with Rule 6(b) of the Rules on Proceedings of the Office of the Ombud, the Office referred the complaint to respondent on 13 May 2013, advising respondent to resolve the complaint with his client. Instead of dealing with the merits of the matter, respondent raised a number of technical defences in his response, namely:

24.1 Respondent objects to complainant receiving help from her daughter who is an attorney;

24.2 Respondent claims that no attempt had been made to resolve the matter with respondent directly, and that no proof of such attempts have been submitted, despite the fact that he has a complaints resolution process in place;

24.3 Respondent further claims that when he contacted complainant to discuss the matter, she indicated that she was not unhappy with his service, but was hopeful that her capital would be refunded following the arrangement scheme;

24.4 Respondent added that following a report from the Nova Board of Directors, it is possible that complainant could be found to have abandoned or repudiated her rights because she chose to follow a different route to recover her loss. Essentially respondent is echoing the same sentiments as communicated in the letter of 6 August 2013, issued by Frontier Asset Management.

[25] On 14 June 2015, the FAIS Ombud addressed correspondence to respondent in terms of Section 27(4) of the FAIS Act informing them that the complaint has not been resolved and that the Office was proceeding towards an investigation. The letter invited respondent to deal with the question of appropriateness of advice, taking into account the risk involved in the investment and how it matched complainant's circumstances. In his response dated 13 July 2016,

respondent again raised the same technical points as noted in paragraph 23, and added that:

25.1 Complainant decided to invest in Sharemax, because her husband had investments which were paying attractive interest rates.

25.2 Complainant inherited money which was in an Absa Fixed Deposit account, however, complainant received low interest rates and was looking to increase her returns. She decided to make the investment in Sharemax Comaro Crossing with a portion of these funds.

25.3 Respondent noted that at the time, he was acting as a representative of USSA[6]. Following the sale of the Comaro Crossing and complainant's pay-out of R107 000, respondent advised complainant that she could either opt to receive the full amount tax free, or reinvest the entire amount in Liberty Mall. The transaction took approximately 4 months to conclude, and respondent is of the view that complainant had sufficient time to reconsider her options. She decided to go ahead with the investment in Liberty Mall.

25.4 Upon making the decision to reinvest with Liberty, complainant was presented with two options: Option A, which would provide higher monthly returns, as well as projections on capital growth, or Option B, which guaranteed the monthly income, annual increase of income and a once-off option after five (5) years to receive back the full capital amount.

[6] Unlisted Securities South Africa, (USSA) was established by Gerhardus Rossouw Goosen while he was a director of Sharemax. Independent brokers like the Respondent - who were licensed in their own right as Financial Services Providers, but lacked the correct license type - were able to market and sell unsecured debentures as representatives of FSP Network Ltd, trading at the time as USSA. FSP Network was finally liquidated in 2013.

25.5 Complainant elected Option B. In respondent's view, considering the guarantees on both income and capital for at least 5 years, the selection was suitable to a conservative investor, as it compared favourably with bank deposits. It would however, appear that following the scheme of arrangement, this option was no longer available to complainant.

25.6 Respondent further stated that it cannot be said that a facility like Liberty Mall which had been trading for approximately 22 years, could be considered a high-risk investment. Respondent does not consider the investment high risk. The fact that it was not listed, had nothing to do with its performance, but with broader economic reasons, claims respondent.

25.7 Respondent further claims that an official risk assessment had been done and complainant was aware that the investment was long term. Complainant, according to respondent confirmed that she had sufficient funds in her bank account for emergencies. Respondent however, provided no document to this Office to support his statements.

Complainant further knew from her previous investment that the shares were not listed. Respondent states that complainant selected the guaranteed plan option, which respondent claims was a "low to medium risk investment class".

25.8 Respondent noted that the value of the property, as well as all other relevant financial details were set out in the prospectus and discussed with complainant. Complainant further signed the quotation.

25.9 Respondent stated that the transfer to Liberty Mall cannot be considered to be in the same category as a new or unfamiliar investment because:

25.9.1 complainant decided to do so based on the options available to her in the letter of choice;

25.9.2 investors were compelled to make a selection as the project had been sold;

25.9.3 complainant had previous exposure to the type of product and its structures, and was satisfied to the extent that she opted to transfer the full capital;

25.9.4 complainant previously opted for the same guaranteed option; and

25.9.5 interest rates were not excessive and her need was for a regular monthly income.

25.10 In light of the aforesaid, respondent is of the view that in the end, there was very little to do in terms of providing advice, apart from reiterating details which complainant was already familiar with. Respondent further stated that there was no client advice record, as everything was done orally. Respondent noted personal information of complainant in his response, but advised that he did not consider it critically important to have a written record when having to assist complainant in selecting an option regarding a matured investment.

25.11 Respondent confirms that he complied with complainant's instructions. The particular situation differed substantially from most in that "providing advice was not materially part of the situation". It was rather a case of finalising the limited options available to complainant.

25.12 Lastly, respondent made much of the Appeals' Board's decision in Siegrist, specifically the comments made by Judge Harms in respect of the scheme of arrangements. More will be said about this later in the determination.

G. DETERMINATION

[26] The following issues arise for determination:

26.1 Whether respondent, in rendering financial services to complainant, violated the Code and the FAIS Act in any way. Specifically, the question is whether complainant was appropriately advised, as demanded by the Code.

26.2 In the event it is found that respondent breached the Code and the FAIS Act, whether such breach caused the loss complained of; and

26.3 the amount of the damage or financial prejudice.

Procedural fairness

[27] As far as procedural fairness is concerned, respondent was provided with at least two opportunities to reply to the complaint, after it was submitted to the Office. The fact that complainant did not comply with rules in referring his

complaint to this Office does not render the complaint invalid[7] and did not prejudice respondent in any way. If respondent required more time to consider the complaint, he could have requested such time when the complaint was first referred to him in terms of Rule 6 of the Rules. Thus, in my view complainant's failure to first refer the complaint to respondent is not fatal.

Record of advice and other documentation

[28] The complaint centres on appropriateness of the advice offered by respondent.

[29] Section 9(1) of the General Code of Conduct provides that:

"A provider must, subject to and in addition to the duties imposed by section 18 of the Act and section 3(2) of this Code, maintain a record of the advice furnished to a client as contemplated in section 8, which record must reflect the basis on which the advice was given, and in particular—

(a) a brief summary of the information and material on which the advice was based;

(b) the financial products which were considered;

(c) the financial product or products recommended with an explanation of why the products selected, is or are likely to satisfy the client's identified needs and objectives;"

[30] The crucial aspect in rendering advice to a client requires collecting information that is necessary and relevant in order to perform an analysis of the client's needs and risk profile, to determine whether the product being considered will

[7] Refer to *Trans-African Insurance Co Ltd v Maluleka* 1956 (2) SA 273 (AD) at 278F – G where the learned judge stated that:"…*technical objections to less than perfect procedural steps should not be permitted, in the absence of prejudice, to interfere with the expeditious and, if possible, inexpensive decision of cases on their real merits*."

be suitable to the circumstances of the client. That means the provider should have an appreciation of the risk that a client can take, based on their circumstances. It is this information that must be reflected in the record of advice along with what other products were considered. The section is mandatory.

[31] By respondent's own admission and in contravention of the Code, no record of advice exists. There is no indication as to what complainant's assets and liabilities were, what her income and expenditure was, means of survival, details of other financial arrangements, and whether complainant had experience in any other financial products. Apart from relying on the fact that complainant previously invested with Sharemax, it is not clear how respondent concluded that the said investment was appropriate for complainant at the time.

[32] Respondent appears undecided as to whether he provided advice to complainant or not. On his own version, after the sale of Comaro Crossing, respondent advised complainant that she could either opt to receive the full amount tax free, or reinvest the entire amount in Liberty Mall. Complainant chose the latter. This is advice as defined in the Act. Section 1 defines advice as:

"any recommendation, guidance or proposal of a financial nature furnished, by any means or medium, to any client or group of clients -

(a) in respect of the purchase of any financial product; or

(b) in respect of the investment in any financial product: or

(c) on the conclusion of any other transaction, including a loan or cession, aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product; or

(d) on the variation of any term or condition applying to a financial product, on the replacement of any such product, or on the termination of any purchase of or investment in any such product, and irrespective of whether or not such advice –

(i) is furnished in the course of or incidental to financial planning in connection with the affairs of the client; or

(ii) results in any such purchase, investment, transaction, variation, replacement or termination, as the case may be, being effected".

[33] Taking into account the aforesaid definition of advice, respondent's contention that there was little for him to do as far as rendering of advice is concerned, is unsustainable. It was respondent's duty to advise complainant of the appropriateness of the Sharemax investment to her circumstances. Respondent's reliance on complainant's supposed familiarity with the Sharemax investment is also misplaced. He had sold the investments to complainant. Judging from his responses to this Office, not much information would have been imparted to complainant regarding the true nature of the investment including the risks involved. I therefore reject respondent's defence that complainant was familiar with the Sharemax investment. Had complainant been familiar with the investment, she would have refused to invest in Sharemax because the investment did not meet her circumstances. She relied entirely on respondent's advice. Respondent had every opportunity to steer complainant away from a risky investment, but failed to do so.

[34] I will demonstrate in a moment that respondent had no appreciation of the magnitude of risk involved in the Sharemax investment. Based on respondent's submissions to this Office, there is no evidence that respondent was even aware of Government Gazette 28690, Notice 459.

[35] The significance of the Government Notice 459 is that the Minister of Trade and Industry, desirous of protecting investors from unfair business practices, decided to have the Notice promulgated with the sole objective of protecting the consumer. The directors of Sharemax at the time are on record in this Office, stating that they had been advised by their lawyers that the notice did not apply[8]. They however failed to provide reasons. They further provided no exemption from the Minister. Given that the people who were in a position of trust *vis a vis* the company, namely the directors, denied that the Notice applied, shows that Sharemax was no place to go for sensitive investors like complainant. To put it simply, Sharemax had set out to deny investors the legal protection afforded by the notice. That, in my view, should spell out the risk that investors were facing. Hence, long before the transfer of the immovable property, the directors withdrew investors' funds from the attorneys' trust account and did what they pleased. Investors were completely on their own here.

[36] On a balance of probabilities, had complainant been fully aware of the risks inherent in this investment, she would not have invested. It seems that respondent simply accepted that owing to signature by complainant and her previous investment with Sharemax, she had accepted the risk. This is

[8] Refer in this regard to paragraph 77 of the Bekker determination (case no FAIS-06661-10/11 WC 1), available from our website: www.faisombud.co.za

disingenuous because respondent knows he had carried out no due diligence and further did not consider the investment to be high risk. Simply informing a client that the investment is not guaranteed does not explain the risk to a lay person. What complainant needed to know is that she stood to lose her capital, because amongst other reasons, the directors of the scheme had chosen to disregard legislation meant to protect investors. The Code requires that the nature of the risk be disclosed to the client in order to make an informed decision. Complainant could not have made an informed decision about the Sharemax transaction.

[37] Respondent ignored the requirements of the FAIS Act which specifically places an obligation on the provider to explain the risk in a financial product to the client. Respondent was in no position to explain something he did not understand. Respondent's comparison of the Sharemax investment to that of a bank deposit, is evidence that he did not understand property syndications at all.

[38] Instead, respondent considered his role in this whole process to be merely that of "facilitator", in total disregard of the Code. Respondent's contradictory information in respect of the risk assessment that was done and the absence of a record of advice, is indicative of his disregard for the law. Had respondent complied with the Code and carried out a proper needs and risk analysis, he would have realised that the high risk Sharemex investment was inappropriate for complainant.

Whether respondent, in rendering financial services, violated the Code and the FAIS Act in any way.

[39] All indications are that respondent did not accept and / or appreciate all the risks inherent in the property syndication. What is more, respondent did not fully apprise himself of the financial situation of complainant, who could not afford to lose any portion of her life savings. Had respondent done so, he would have known that placing the bulk of complainant's funds into a property syndication would yield nothing but disastrous results for complainant, which is what occurred in this instance. As a result, complainant has been without income for some time now. I find that respondent was negligent in advising complainant to invest in Sharemax. Complainant simply did not have capacity for high risk investments yet respondent went ahead and advised her to invest in it.

[40] Respondent relies on complainant's signature on the quotation and her previous experience in investing in Sharemax and argues that she understood the risks. Taking into account the complexity of the prospectus, it is unlikely that complainant would have read and understood the prospectus. Respondent failed to disclose the risk involved in the investment, in violation of Section 7(1). The section calls upon providers other than direct marketers to 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***. '(*My emphasis*).

[41] Section 3 (1) (a) (iii) clearly states that representations made and information provided to a client must be adequate and appropriate in the circumstances of the particular financial service, taking into account the reasonably assumed knowledge of the client. As the expert, had respondent carried out the

necessary due diligence, he would have been in a better position to advise complainant on a product that is suitable to her, taking into account her circumstances. He could not do so, because respondent, in violation of section 2 of the Code, had carried out no due diligence.

[42] What is evident from the facts is that there was no incentive for respondent to recommend any other product other than Sharemax. Had respondent sold an appropriate investment he would have missed out on the lucrative commission paid by Sharemax, which commission was by industry standards out of kilter with the rest of the institutions.

Did respondent's conduct cause complainant's loss?

[43] Based on complainant's version, the investment in Sharemax was as a result of the respondent's advice. This means, had it not been for respondent's advice, complainant would not have made the investment. This answers the test for factual causation.

[44] The next step is to establish whether, as a matter of public and legal policy, it is reasonable to impose legal responsibility on respondent for the failure of the investment. In other words, could respondent have reasonably foreseen the collapse of Sharemax.

[45] 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 complainant and the general manner of the harm occurring was reasonably foreseeable.

[46] Given that respondent had carried out no due diligence on Sharemax and its syndications, it was negligent of him to advice complainant that the investment was good and safe. Respondent relied solely on the fact that the Liberty Mall had been in existence for 22 years, but failed to take into account any of the factors as provided for in Notice 459. On this basis alone, he should not have advised any client on this investment. Thus, a skilled and responsible FSP, acting according to the Act and the Code, would not have advised complainant to invest in Sharemax.

[47] If respondent did his work according to the Act and the Code, no investment in Sharemax would have been made, bearing in mind complainant's age and capacity to withstand the risk of losing her capital. It is easy and convenient to impute loss to director mismanagement or other commercial causes. In this case however, complainant's loss was not caused by management failure at Sharemax, but respondent's inappropriate advice. That the risk actually materialized, for whatever reason, is not important. Otherwise the whole purpose of the Act and the Code would 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.

[48] The loss suffered by complainant as a result of respondent's inappropriate advice was reasonably foreseeable by respondent. I refer in this regard to

Standard Chartered Bank of Canada v Nedperm Bank Ltd[9] where the Court held 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."

[49] Information at this Office's disposal points to the following conclusions:

49.1 Had respondent followed the Code, he would not have recommended an investment in Sharemax. Being acutely aware of complainant's circumstances, he would have found an investment that is commensurate with complainant's circumstances.

49.2 When respondent recommended the investment in Sharemax, he could not have been acting in complainant's interest.

49.3 Respondent failed to conduct due diligence on the Sharemax investment, and could therefore not have known what he was inviting complainant to invest in when he recommended the investment. Respondent needed to comply with the law.

49.4 There is no evidence that respondent was truly aware of the risk involved in Sharemax. These include the lack of apparent safe guards to protect

[9] 1994 (4) SA 747 (AD)

investors against director misconduct; the lack of visible governance arrangements; and the complicated structure of the investment itself, which left the investors with no protection.

[50] I find that, in advising complainant to invest in Sharemax, respondent contravened sections 2; 3, 7 (1) and 7 (2); 8 (1) 8 (2); and 9 of the Code. I also find that this conduct was the cause of complainant's loss.

H. QUANTUM

[51] Complainant invested an amount of R107 000.

[52] Accordingly, an order will be made that respondent pay to complainant an amount of R107 000 plus interest.

I. THE ORDER

[53] In the result, I make the following order:

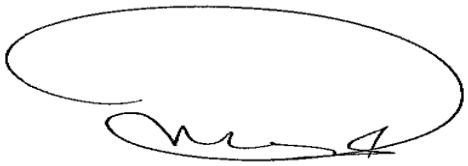
1. The complaint is upheld.

2. Respondents are ordered to pay complainant, jointly and severally, the one paying the other to be absolved, the amount of R107 000.

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

4. Upon receipt of payment, complainant will cede her rights to any further claims to respondent.

DATED AT PRETORIA THIS THE 24th DAY OF NOVEMBER 2016.



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OMBUD FOR FINANCIAL SERVICES PROVIDERS