IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS PRETORIA

CASE NUMBER: FAIS 00838/13-14/ GP 1

In the matter between:

HAROLD SYDNEY 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 in Sharemax The Villa Retail Park Holdings 2 Limited[1]. The basis of the complaint is that respondent advised complainant to invest in a high risk scheme that was incompatible with his personal circumstances as pensioner.

[1] Registration number 2010/010049/06

B. THE PARTIES

[3] Complainant is Harold Sydney Jackson, an adult male pensioner whose full particulars are on file with the Office.

[4] First respondent is Johan Nell Financial Services CC, registration number 2000/059266/23, duly registered in terms of South African laws. The Regulator's records indicate respondent's (we use the principal place of business or registered office for these) address as 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. Regulator's records indicate respondent's address as 39 Wild Peach Villas, Woodlands Drive, Pinehurst, 7550.

[6] At all material times, second respondent rendered financial services to complainant.

[7] I refer to first and second respondents as respondent. Where appropriate I specify.

C. BACKGROUND TO SHAREMAX

[8] Sharemax Investments (Pty) Ltd 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.

[9] On 13 September 2005, Sharemax was granted a licence to act 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).

[10] Sharemax issued prospectuses regarding the various 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.

[11] 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 notice 28690, Notice 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.

[12] 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).

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

[14] Following an inspection during 2010 conducted 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 as a bank. The subsequent intervention by the Reserve Bank resulted in frozen investments and massive building operations being uncompleted and lying dormant.

[15] 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.

[16] 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.

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

[18] A few interesting points to note:

18.1 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].

[2] 90 of 1989

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

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

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

18.3 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].

18.4 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

[19] Complainant had a long-standing relationship with respondent, for a period of approximately five years, during which complainant dealt with respondent who assisted him with the buying and selling of various Sharemax investments. Complainant stated that investing in this manner was profitable at the time. Complainant trusted the advice of respondent, whom complainant considered qualified to render financial services in connection with this product.

[20] On 18 August 2009, complainant invested an amount of R100 000 with Sharemax The Villa. During July 2010, complainant invested a further amount

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

of R80 000, also in The Villa. However, shortly after this investment the syndication collapsed. Complainant received interest payments on the first investment for a couple of months and nothing on the second investment.

[21] Complainant was assured by respondent that the investments in Sharemax were low to medium risk investments. The Villa was explained and marketed to complainant as the largest shopping centre in the southern hemisphere, offering very good interest rates.

[22] Complainant indicated that at the time of making this investment he was already 69 years of age and sickly. His arm had been amputated as a result of illness and he is in no position to make-up for the losses he suffered following the collapse of Sharemax. The money he utilised to make the investments stem from his life savings.

[23] Despite various attempts to resolve the matter with respondent, complainant was not successful.

E. RELIEF SOUGHT

[24] Complainant seeks repayment of the combined amount of R180 000.

[25] 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

[26] 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 27 June 2013, advising respondent to resolve the complaint with his client. In submitting his response and supporting documentation, respondent instead of dealing with the merits of the matter, raised a number of technical defences namely:

26.1 Respondent objected to complainant receiving help from his daughter who is an attorney;

26.2 He claimed that no attempt had been made by complainant to resolve the matter with respondent directly, and that no proof of such attempts had been submitted, despite the fact that he has a complaints resolution process in place;

26.3 Respondent states that The Villa was in fact a viable investment, quoting extracts from various unreferenced documents and brochures to substantiate his statements; and

26.4 Respondent states that complainant is not new or unfamiliar with investments in property syndications. Respondent is of the view that the blame for the collapse of the scheme should be found elsewhere, and not with him.

[27] On 12 June 2015, the FAIS Ombud addressed correspondence to respondent in terms of Section 27(4) of the FAIS Act informing respondent that the complaint has not been resolved and that the Office had intentions to investigate the

matter. Respondent was invited to provide the Office with its full case together with supporting documents in order for the Office to begin its 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. No response to this letter was received.

G. DETERMINATION

[28] The following issues arise for determination:

28.1 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.

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

28.3 the amount of the damage or financial prejudice.

Procedural fairness

[29] Respondent made much of the fact that in his view, a proper process was not followed. However, as far as procedural fairness is concerned, respondent was provided with at least two opportunities to respond to the complaint. The fact that complainant did not comply with rules in referring his complaint to this Office does not render the complaint invalid[6] and did not prejudice respondent in any

[6] 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*."

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

[30] The complaint revolves around the appropriateness and suitability of advice by respondent.

[31] Annexed to the response provided by respondent, was a record of advice relating to the 2009 investment. The following is noted in the record:

31.1 clients objectives: to receive a monthly income for a fixed term of 5 years, at a competitive interest rate by investing an amount of R100 000. The capital must be secured;

31.2 financial situation: a fixed term bank investment has matured. The reduced interest rates are not acceptable to the client, therefore, he is considering alternative investment options;

31.3 product experience: client has invested in fixed property, owned and sold commercial property, invested in life insurance income-producing products, as well as capital growth products. He holds a savings account and invested in property syndications before. What was not noted in this record, is that complainant was self-employed as a mechanic, and did not have any formal qualifications.

31.4 important information highlighted to client: explained the investment as unsecured and regarded as medium to long-term with shares that are not liquid. If the client wished to sell the shares prematurely, he would have to find his own buyer. The property might underperform, putting strain on tenants who pay rentals that secure the income to investors. Respondent indicated here that based on due diligence conducted and the signed lease contracts with their annual increases, it made the projected income and capital growth very likely to be achieved. An agreement was furthermore in place with the seller of the mall for periods ending one, two, three and four years prior to occupation which had excellent possibilities for the investor regarding capital growth over and above the initial gross investment made. I refer in this regard to the Siegrist[7] determination where I have comprehensively dealt with the proposed agreement. What it in fact resembled, was an attempt to encourage advisors to push for more sales.

[32] The problem with this record of advice, is that it contains little personal information about complainant in order to answer the question of appropriateness. There is no indication as to what complainant's income and expenditure was at the time. There is also no indication of where complainant draws his income and how regular the income is. All of this information is necessary to understand complainant's risk profile and capacity to absorb risk. There is no indication that any other products were offered to complainant, outside of property syndications.

[7] FAIS-00039-11/12 GP 1, available from www.faisombud.co.za/determinations

[33] An unsigned copy of a needs analysis and record of advice for the second investment in 2010 was also provided. The following is noted:

33.1 the purpose of the investment was to receive competitive monthly income by investing a single lump sum for a minimum period of 5 years;

33.2 that complainant had no debt but had funds in a savings account and a fixed deposit with the bank. The cottage complainant owned was fully paid for and he had emergency funds available.

33.3 complainant made similar investments with Sharemax and PIC before.

33.4 the basis for offering the Sharemax investment was that complainant had funds from an investment that matured, and required higher interest on the investment as opposed to what was offered by the banks. Complainant, according to respondent was satisfied with the returns previously received as it had been providing him regular income in the past.

[34] 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;"

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

[36] 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. The risk profile done in 2009 concluded that complainant was a moderate investor. This implied, as per respondent's records, that complainant was an investor who wanted reasonable but relatively stable growth. Some fluctuations would be tolerable, but this type of investor wants less risk than that attributable to a fully equity based investment.

[37] On his own version, respondent makes the point in his first record of advice that complainant required his capital to be secured yet respondent went on to recommend a product that did not secure capital. Placing complainant's funds in a high risk property syndication, is the exact opposite of what is required for a moderate investor who requires security of his capital. This is indicative of the

fact that respondent did not appreciate the risks involved with investments in property syndications.

[38] The fact that complainant had a fully paid property and some savings in the bank, is no justification for advising complainant to proceed with a high-risk investment. The question that should have been answered by respondent, is whether complainant had capacity to absorb any loss he might suffer. At the time of making the investment, complainant was 69 years of age, and not healthy. In violation of section 8 (1) (a) to (c) respondent failed to recommend an investment that was in line with complainant's circumstances at the time. 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, he would have refused to invest in Sharemax because the investment did not meet his needs. It is as simple as that. The prospectus contained warnings that the capital is not guaranteed.

[39] I will demonstrate in a moment that respondent had no appreciation of the magnitude of risk involved in the Sharemax investment. It is unlikely that respondent was aware that the prospectus had to comply with Government Gazette 28690, Notice 459, or that he was aware of the existence of this notice.

[40] 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 to 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.

[41] On a balance of probabilities, had complainant been fully aware of the risks inherent to this investment, he would not have proceeded with the investment. It appears to me that respondent simply accepted that owing to complainant's signature and his previous investments with Sharemax, he accepted the risk. That is disingenuous because respondent knows he had carried out no due diligence and further did not consider the investment to be high risk, thus, he would not have communicated the true nature of the risk involved to

[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

complainant. Simply informing a client that the investment is not guaranteed does not explain the risk to a lay person.

[42] What complainant needed to know is that he stands to lose his capital, because amongst other reasons, the directors of the scheme have 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.

[43] 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 or other equities, is evidence that he did not understand property syndications at all.

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

[44] 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 his life savings. Had respondent done so, he would have known that placing complainant's life savings, at age 69, into a property syndication would yield nothing but disastrous results for complainant, which is

what occurred in this instance. Complainant simply did not have capacity for high risk investments.

[45] 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*).

[46] 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 inform complainant on product suitability, taking into account his circumstances. He could not do so, because respondent, in violation of section 2 of the Code, had carried out no due diligence.

[47] What is evident from the facts is that there was no incentive for respondent to recommend any other product than Sharemax. Since respondent was not licensed to sell unlisted shares and debentures, he acted, under supervision, as a representative of USSA[9]. If respondent had sold an appropriate investment

[9] At the time, Unlisted Securites South Africa was a licensed service provider with license number 6152

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 in the financial services industry.

Did respondent's conduct cause complainant's loss?

[48] 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.

[49] 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.

[50] 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.

[51] Given that respondent had carried out no due diligence on Sharemax and its syndications, it was negligent of him to advise complainant that the investment was good and safe. Respondent failed to take into account 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.

[52] 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.

[53] 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*[10] 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."

[10] 1994 (4) SA 747 (AD)

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

54.1 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.

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

54.3 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.

54.4 There is no evidence that respondent was truly aware of the risk involved in Sharemax. This includes the lack of apparent safe guards to protect 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.

[55] 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

[56] Complainant invested an amount of R180 000.

[57] Accordingly, an order will be made that respondent pay to complainant an amount of R180 000 plus interest.

I. THE ORDER

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

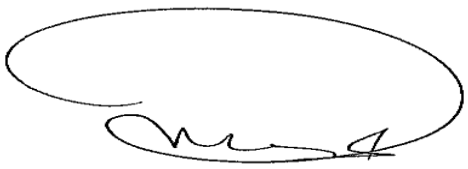
1. The complaint is upheld.

2. The respondent is ordered to pay the combined amount of R180 000 to complainant.

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 his 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