

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS: 02201/09-10/KZN/1

In the matter between:

PEGGY JOHANNA GRANTHAM

Complainant

and

SHEVGEM INVESTMENTS CC t/a RANDSURE BROKERS

1st Respondent

JAMEY RANDALL

2nd Respondent

**DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY
AND INTERMEDIARY SERVICES ACT 37 OF 2001 (“THE FAIS ACT”)**

A. THE PARTIES

[1] Complainant is Peggy Johanna Grantham an adult female pensioner who resides in Pietermaritzburg, Kwazulu Natal.

[2] The First Respondent is Shevgem Investments CC, trading as Randsure Brokers, a closed corporation duly registered in terms of South African laws with its principal place of business situated at 1 Connor Road Chase Valley, in Pietermaritzburg. The First Respondent is an authorised financial services

provider in terms of the FAIS Act, with licence number 18857, represented by Jamey Randall (Randall), a member and key individual of the First Respondent.

[3] The Second Respondent is Jamey Randall, an adult male, and a key individual of the First Respondent, who shares the same address as the First Respondent.

[4] At all times material hereto, complainant dealt with 2nd respondent who represented the 1st respondent. In this determination, for the purposes of convenience, I refer to the 2nd respondent as “the respondent”. The second respondent was at all relevant times representing the 1st respondent.

Edwafin Investment

[5] The facts of the present complaint are materially the same as those which arose in the determination of **Ethel Elouise Blessie v Shevgem Investments CC, FAIS No. 02202/09-10/KZN/1** (“the Blessie determination”). In fact, the complainant in the present matter was a recipient of a debenture certificate alongside two other beneficiaries of the late Mr Smith. One such beneficiary was Ethel Elouise Blessie whose complaint was dealt with in the aforementioned Blessie determination. The complainant was married to the late Mr. Smith. The cause of complaint arose from financial advice the second respondent gave to the late Selwyn Ronald Smith, who was complainant’s late husband. Mr Smith’s beneficiaries subsequently lodged complaints against the first and second respondents alleging that they

failed to render financial service in accordance with the provisions of the FAIS Act. The complainant therefore alleges that respondents' failure to comply with the Act led to the loss she subsequently sustained.

[6] However, for convenience, the three beneficiaries of the deceased, including the complainant, are dealt with in three separate determinations. Following the Blessie determination, this is a second of such determinations.

[7] Before embarking on the facts of the present complaint, it is perhaps convenient to sketch the background of Edwafin Investment.

[8] Edwafin Investment Holdings was a subject of the previous Determination in the matter of *Vinesh Mohanlal v Raj Chutterpaul & Another (CASE NO. FAIS 05679-09/10 KZN)*("the Mohanlal determination"). In Mohanlal, I had occasion to examine and deal with the entire Edwafin Investment scheme at some considerable lengths.

[9] It is opportune to once again deal with the salient aspects of the Edwafin Investments. Edwafin Investments was a registered financial services provider with FSP number 31990. Essentially, the scheme operated as a venture capital company which was ultimately liquidated. Edwafin Investments were the majority shareholders in Dynamic Motor Company, Edwabond Capital Options, Rainbow Paints and Edwafin Foundation. Edwafin came to prominence during 2005 with a much publicised debenture offer. It was borrowing money from members of the general public, mainly pensioners and teachers in an attempt to fund its investments.

[10] It is now common cause that the Edwafin Investments was placed under liquidation and its licence was withdrawn by the regulator, the Financial Services Board. When the cause of the present complaint arose, Edwafin was still operating and had not been placed under liquidation.

[11] The complainant's case is built on the documents that were submitted to this Office by the respondent as part of his response to the present complaint. There is no material dispute of fact, and the only issue for determination is whether the respondent's advice complied with the provisions of the FAIS Act, including its General Code of Conduct ("the Act").

[12] The focal point of the investigation and the determination of this matter centred on the time when the respondent rendered financial advice to the complainant's late husband.

[13] During October 2008, one of Edwafin's investors brought an application for its liquidation in the Natal Provincial Division in Pietermaritzburg. That application was occasioned by Edwafin's failure to meet its financial obligations to its investors which resulted in non-payment of investors' interest since October 2008. Subsequently, the Financial Services Board ("the FSB") suspended the FSP licence of Edwabond, a subsidiary of Edwafin. Edwafin issued debentures in terms of the Companies Act and marketed them through Edwabond. Edwabond was thus subject and bound by the provisions Financial Advisory and Intermediaries Services Act ("FAIS Act").

[14] Although the Second Respondent was a licensed financial services provider, investigations by this Office revealed that he was however not licensed as required by the Act to sell debentures. I will revert later to the significance of the latter point.

B. THE COMPLAINT

Background to the Complaint

[15] The factual background to the present complaint can succinctly be summarised in the following paragraphs.

[16] The complainant's late husband, Mr B.R Smith, ("the complainant's husband") had been employed by the Umsunduzi Municipality for a period of thirty (30) years, and was due for retirement on attainment of the age of sixty five (65).

[17] In September 2007 at the age of 62, the complainant's husband suffered a stroke. He was subsequently diagnosed with stage four cancer.

[18] After diagnosis, the family was advised by the doctors that the complainant's husband would only live for a maximum of 18 months after the operation. He had to undergo new treatment. This treatment was aimed at prolonging his life for a few more months.

[19] In December 2007 when the complainant's husband's health had deteriorated further, he was advised by the second respondent to take an early retirement and invest his money.

[20] The complainant's husband's condition deteriorated further and he started experiencing memory loss and his walking pace had become relatively slower. He could no longer dress himself properly. He put his shoes the wrong way and could not button his shirts properly or fasten his belt. Indeed, it is common cause that the complainant's husband had become confused about the time of the day and could no longer read the time. In my view though, nothing turns on this bit of detail as there is no suggestion that when advice was rendered, the complainant did not understand its import.

[21] Notwithstanding the complainant's husband's description as set out in the preceding paragraphs, respondent asserts he was still fit to carry out normal activities, and was in his sound and sober senses when financial advice was rendered. As mentioned already, nothing turns on this issue.

[22] In February 2008 the second respondent invested R600 000 of the complainant's father's money into Edwafin Investment Holdings. The second respondent invested a further R 300 000 into Dynamic Wealth. According to the second respondent the interest yielded by both Edwafin and Dynamic Wealth was much higher than that offered by traditional financial institutions such as the banks. However, the complainant's husband regrettably passed away on the 13th May 2008 before any interest had been paid out to him.

[23] After the death of the complainant's husband, the second respondent issued debenture certificates to the complainant and some of her children.

[24] Shortly after the death of the complainant's husband, the second respondent approached the family and advised that they were each beneficiaries of debentures to the value of R 100 000 each. I should pause to mention that the second respondent was married to the complainant's and her late husband's daughter. The second respondent is therefore the complainant's son in law. The second respondent told his in-laws, that is the complainant and other beneficiaries, that the capital amount would be paid out to each one of them after five years and that in the interim they would each be receiving interest which would be paid on a monthly basis.

[25] The complainant was issued with Debenture certificate No. J 129, and she received 100 debentures.

[26] In September 2008, the complainant received her interest. However, at the end of October 2008 the complainant and two other beneficiaries each received a telephone text message (the so-called "SMS) message" from Edwafin Investment Holdings informing them that Edwafin was experiencing problems with their electronic payments and that a cheque would be posted instead. As promised, the complainant received the cheques for the months of October and November 2008. However, the cheques could not be honoured on account of insufficient funds. After several desperate attempts to follow up on the dishonoured cheques, complainant and other beneficiaries received letters from Edwafin informing them that the company was experiencing cash flow problems.

[27] The complainant failed in her attempts to recover her money from Edwafin. She then lodged the present complaint and alleged that the respondent had failed to render financial advice in accordance with the FAIS Act.

C. RELIEF SOUGHT

[28] The complainant contends that the respondents were negligent in advising her husband to invest into Edwafin. Accordingly, she seeks compensation from the respondents in the amount of R 100 000 together with interest.

D. INVESTIGATION

[29] Upon receipt of the complaint, on 27th October 2009 this office sent out correspondence requesting the second respondent to resolve the complaint directly with the complainant. Furthermore the respondent was informed that there were other similar complaints which had also been lodged by a number of his clients. What perhaps compounded matters was the fact that this appeared to be a family squabble as the second respondent's own wife also had her money invested by the second respondent into Edwafin. Since the laying of the complaints against the respondents, various unsuccessful attempts have been made to try and resolve the matter.

[30] When the parties failed to informally resolve the matter, the complaint was then accepted for formal investigation. Thereafter a notice in terms of section 27(4) of the FAIS Act was issued and the respondent was requested to submit his response together with all other necessary documentation in terms of the Act.

E. THE RESPONSE

[31] The second respondent submitted his response and in the process also furnished this office with supporting documentation.

[32] The respondent submitted the same response in respect of all the complaints. The salient points of the response are as follows.

[33] During 2007, second respondent rendered financial services to the complainant's husband. During the course of such advice, second respondent began assisting the complainant's husband with retiring from his provident fund. He states that he advised the complainant's husband to invest with Edwafin because at the time Edwafin was giving very competitive interest rates as opposed to a guaranteed income from a guaranteed fund.

[34] The second respondent submitted that he conducted a thorough due diligence of Edwafin's audited financial statements before investing the complainant's husband's funds.

F. RESPONDENT'S RECORD OF ADVICE

[35] As part of his response to this office, the respondent submitted a record of advice in terms of section 9 of the General Code. The section requires all Financial Services Providers ("FSPs") to maintain records of advice furnished to their clients, the financial product/s considered and the basis for concluding that the selected products would best suit the clients' circumstances. In this

connection, the respondent submitted these records in compliance with the Code and as requested by this Office.

[36] In what follows below, I deal with relevant portions of the record of advice.

[37] Section C is headed "*Products Considered*", and these are listed as "*Edwafin and Dynamic Wealth, Discovery and Liberty*".

[38] The next section is Section D and is headed "*Initial Recommendation/ Advice & Motivation*".

[39] Under the column "Motivation" which sets out the reasons for recommending EDWAFIN, the following entry is made:

"as they are giving Mr. Smith 20% in interest on R600 000 and this will add up to R10 000 pm which is what Mr. Smith earned just before he fell ill."

(Original Quotation)

[40] Similarly, under *Dynamic Wealth*, the reason for recommending *DYNAMIC WEALTH* is set out as follows:

"Money market, as they are giving the highest interest and the money R300 000 is available on two days' notice."

(Original Quotation)

[41] Section E is entitled: “*Important information Highlighted to Client*”. Under this heading, the following entry is noted:

“EDWAFIN is considered to be moderate to high risk as it is an unsecured debenture. However, given Mr. Smith’s poor prognosis as he was diagnosed with a very rapid growth and terminal illness (cancer) it is recommended that he receives the highest income as his medical expenses and living arrangements would be financially taxing and would be difficult to maintain on less monthly income than he was used to.”

(Original Quotation)

[42] A striking feature of the respondent’s record of advice and his response to this office is that there does not appear to have been any explanation given on the nature of the risk associated with the Edwafin investment. The entry made in the record of advice simply vaguely refers to the Edwafin investment as “moderate to high risk” investment. However, the objective fact which should have been conveyed to the complainant’s husband was that as an unsecured debenture, the Edwafin investment was by its very nature a high risk investment. What is more, Edwafin was a new entrant in the investment space. There was no one who could refer to, although this is no guarantee of the future, any track record of the entity. The respondent himself had not satisfied himself as to what governance arrangements were in place to mitigate the risk that false information could be published about the company to the detriment of the investors. It was simply disingenuous and misleading to even suggest that the Edwafin product was “moderate” in any way. The

second respondent does not seem to have paid any attention to the viability of the Edwafin investment. The high risk nature of this investment is further compounded by fact that Edwafin had no trading track record, and second respondent ought to have closely examined this aspect before committing funds to the company. This fact alone should have called for a close examination of Edwafin's viability.

[43] Proper due diligence requires the financial services provider to examine the company and the product it sells beyond the company's marketing material. Thus among other basic things required when conducting due diligence, the financial services provider checks on the legitimacy of the company to see whether it is properly registered and licensed by the industry's regulating body, establishes its trading history, examines the structure of that company to see whether it adequately affords protection to investors, looks into its directors, and examines the viability of the product sold and see if it is compatible with the needs of the investor. The financial services provider who renders advice should be able to separate objective facts from marketing hype. It goes without saying that there is a duty on the financial services provider to carefully examine any extravagant claims made on the probable success of the product. In that regard, the financial services provider ought to examine any promises of huge returns and determine if these are attainable judging from the underlying economic activity. There are several other factors that must be taken into account, they are not exhaustive and it is not necessary to list them all here.

[44] In the present matter, the Edwafin investment promised a return of 20% interest which was out of kilter with the single digit interest promised by established financial institutions. No information was furnished as to how this extravagant interest would be raised. Instead the second respondent simply accepted this claim without more.

[45] A simple look at the Edwafin scheme and the extravagant claims made in several of its glossy brochures would have raised the suspicion of any reasonable financial services provider that they could be dealing with a pyramid scheme. Indeed Edwafin investment bore all the hallmarks of a pyramid scheme. Stripped of the facade of its legality in the form of licensing, the substance of Edwafin indicated that the scheme was clearly unworkable. Had the second respondent properly conducted the due diligence of Edwafin Investments, he would have noticed all the cracks that were apparent in the scheme. These flaws were not hidden but could only be gleaned through the lenses of the factors mentioned in paragraph 43 of this determination above.

[46] It follows therefore that it was not in the interest of the complainant's husband to invest almost all his pension a high risk scheme. Not only was Edwafin unsuitable to the financial needs of the complainant, it was clearly incompatible with his risk profile.

[47] What is more, the investment of the complainant's husband's money into Edwafin was clearly at variance with the results of risk analysis conducted during the course of rendering financial advice. The results of the risk analysis had indicated that the complainant's husband was a moderate investor. To be

sure, the risk tolerance of the complainant's husband put him out of bounds of such high risk investment as Edwafin. However, for reasons that are entirely at odds with these risk profile results, the second respondent went on to advise the complainant's husband to invest in Edwafin.

[48] Clearly, the entire exercise of going through the risk analysis was a mere formality performed ostensibly to comply with the formal requirements of the FAIS Act. There was no analysis of the results and what the implications of investing in such high risk product entailed. In a word, the substance of the Edwafin product was clearly not suited to the needs and circumstances of the complainant's husband. This is not to say, the financial services provider is expected to eliminate all sorts of risk. Certainly, the high risk involved in this product had a lot to do with viability and questions around governance to mitigate the risk of directors helping themselves from the pot.

[49] In breach of the FAIS Act and the General Code, the second respondent completely ignored the results of the risk analysis and invested the complainant's husband's money into the high risk Edwafin.

[50] The following passage from the second respondent's response furnished to this office is instructive and merits further consideration. In a letter dated 05th January 2010, the respondent stated as follows:

"My reason for advising Mr Smith to invest with Edwafin at that time is that they were giving 20% p.a interest as opposed to a guaranteed income of 10% in a guaranteed fund."

“On my perusal of Edwafin’s audited financials, it reflected that they were in a good financial position as they made a substantial profit despite paying out high interest to debentures holders and thus I gathered that the business was sound as this reflected on their Audited Financial Statements and therefore I did not suspect any foul play.”

(Original Quotations)

[51] The second respondent’s claim that he had conducted due diligence by examining the audited financial statements and books of Edwafin cannot be correct. In the first instance, no proof of such audited financial statements was ever made available to the public or this office. No proof was furnished of any substantial profit having been made by Edwafin, nor did any such profit ever take place. The objective fact remains that Edwafin had no previous trading history or track record and it could not therefore have made any profit as alleged by the second respondent.

[52] The obvious starting point for any meaningful due diligence is the examination of the company’s prospectus. In the present case, the second respondent did not bother to check the company’s prospectus but instead relied on extravagant claims contained in the glossy marketing material.

[53] Although it is commendable that the second respondent maintained and kept proper records of financial advice rendered, he did not seem to have paid any heed to the various provisions of the Act and the Code.

G. THE ISSUES

[54] The main issue for consideration is whether the respondent gave proper advice to the complainant's deceased husband. In that regard, the quality of advice furnished by the respondent is readily ascertainable from the record of advice which is required by provisions of the Code.

[55] Inextricably linked with the quality of advice furnished by the respondent is the question of whether the respondent conducted the necessary due diligence on the product he invested the complainant's husband's money. Of course all these issues require, as a starting point, an examination of whether the respondent was competent to sell the product he recommended to the complainant's husband.

H. FINDINGS

[56] It is common cause that the respondent was not licensed to sell debentures. In his response, the second respondent himself conceded that his license did not include the selling of debentures; however, he thought the financial product he sold to the complainant's husband was the best choice as it yielded higher returns than conventional investments.

[57] Given the unusually high returns the product promised, the second respondent ought to have carefully examined the viability of the product and determined whether the extravagant claims made were attainable. Had the second respondent done that, he would certainly have come to the realisation

that the huge returns promised were certainly not practical or economically sustainable.

[58] In any event, the product sold to the complainant's husband was an unsecured debenture for which the second respondent possessed neither the skill; training nor the expertise to sell.

[59] The second respondent was in breach of the FAIS Act in selling a financial product for which he was not licensed.

[60] The FAIS Act and the Code place a duty on the financial services provider (FSP) to act with due skill, care and diligence. This duty ensures that FSPs act with responsibility and that the consumers are adequately protected from financial products which may be to their detriment. It is only those financial products which stand to benefit the consumer which should be sold to members of the public. In failing to conduct proper due diligence of the company and its product, the second respondent failed in his duty to act with care and skill required of an FSP.

[61] The integrity of the financial services can only be protected when FSPs act with the care and skill as set out in the FAIS Act and the Code. Regrettably, the second respondent failed to disclose his limitation (namely, that he was not licensed to sell unsecured debentures unsupervised) to the complainant and her husband. In that regard, the second respondent sold a product he clearly did not understand. That being the case, the second respondent would not have been in a position to examine the product and properly advise the

complainant's husband of any shortcomings in the financial product on offer because he was none the wiser.

[62] The above being the case, the second respondent was in breach of the FAIS Act and the Code when he advised the complainant's husband to invest in Edwafin. That breach of the Code resulted in the loss of the complainant's investment made into Edwafin.

I. THE ORDER

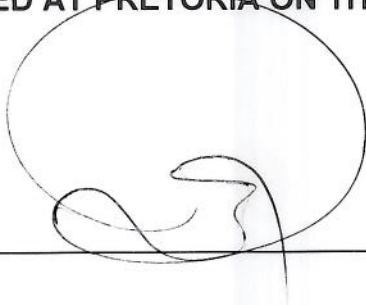
[63] In the result, I make the following order:

1. The complaint is upheld.
2. The first and second respondents are jointly and severally liable for the payment of the complainant's money.
3. The first and second respondents are jointly and severally liable, the one paying and the other one being absolved, and are ordered to pay to the complainant:

3.1 The amount of R 100, 000.00;

3.2 Interest on the amount of R100, 000.00 at the rate of 15, 5% per annum from a date seven (7) days from date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 20th DAY OF AUGUST 2013.

A handwritten signature in black ink, consisting of a large circle followed by a stylized, cursive-like flourish. The signature is positioned above a horizontal line.

NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS

