APPEAL BOARD OF THE FINANCIAL SERVICES BOARD

CASE NO: FAB 3/2016

In the application between:

RAJ CHUTTERPAUL **First Appellant**

RAJ CHUTTERPAUL BROKERS CC **Second Appellant**

and

VINESH MOHANLAL **Respondent**

DECISION

A. THE APPEAL

1.

This is an appeal against the decision of the Financial Advisory and Intermediary Service (FAIS) Ombud.

Leave to appeal was granted to the Appellants in terms of Section 28(5)(b(ii) of the FAIS Act on the 19th May 2016. This appeal is limited to the question whether the Appellants in rendering advice to the complainant were in breach of Section 2 of the Code of Conduct, namely whether the findings of fact and the conclusions drawn in the original and the second determinations were justified. For the purposes of this decision the Respondent will be referred to as the complainant as well.

2.

An appeal to this Appeal Board must be decided on the written evidence, factual

information and documentation which had been submitted to the decision maker (in this case the FAIS Ombud) in connection with the matter, which is the subject of the appeal. By virtue of Section 26(B)(15) of the FAIS Act, this Appeal Board may only confirm, set aside or vary the decision under appeal, order that any such decision of the Appeal Board may be given effect thereto or remit the matter for reconsideration by the decision maker concerned in accordance with such direction if any, as the Appeal Board may determine.[1] Simply put this appeal is limited to the record before it.

3.

B. FINDINGS OF THE OMBUD

This matter has a long history and spans over a few years with the Ombud furnishing at least two determinations and both parties given an opportunity to provide further evidence in considering the matter.

3.1 The main issue in respect of this matter turns on whether the Appellants were in breach of the General Code of Conduct for Authorised Financial Service Providers and representatives. (BN 80 OF 8 AUGUST 2003 as amended – referred to as the Code of Conduct).

3.2 The Ombud's finding was essentially based on the fact that the Appellants had not complied with the Code of Conduct in that he failed to act honestly, fairly and with due skill, care and diligence in the interest of his clients and the integrity of the Financial Services Industry. The Ombud also found that the Appellants were not licenced to sell the Edwafin Bond Debentures ("the product").

[1] Potgieter v Howie N.O. and Others 2014 (3) SA 336 GP

3.3 More particularly Section 2 of the Code of Conduct which stipulates

"At all times render financial services honestly, fairly, with due skill, care and due diligence and in the interests of clients and the integrity of the financial services industry."

3.4 In her second determination the Ombud persisted with her finding that there was no proper due diligence done on the part of the Appellants when advising the client in respect of the product. The Appellants were aware that the product was high risk. Edwafin (the investment) was in financial trouble already and was defaulting on payments to investors at the time when the investment was recommended to the complainant. The Appellants could reasonably foresee that there was a real prospect that the investment proposed will fail.

3.5 It was at least required that when conducting due diligence, reference should have been made to the steps taken by the Appellants in establishing that the investment was viable, sustainable and fair to their clients. At the time when the investment was proposed, there was already wide publicized information in the financial media that Edwafin was a risk and that it was defaulting on its payments to investors. Edwafin's prospectus further identifies that this was a high risk investment and more so the auditors of Edwafin pointed out that there was a risk that the investment was failing.

3.6 The Ombud established that the investment was made on the 16th October 2008 and by the 17th November 2008, Edwafin was a failed investment.

3.7 Insofar as understanding the risk of loss was concerned, the risk of capital was never explained to the complainant. The only thing that was explained was the risk of losing interest on capital and there was a risk that the interest may fluctuate down to 0%. The complainant was willing to take this risk insofar as losing the interest was concerned. The Ombud concluded that the complainant

would not have invested had he been told that Edwafin was not safe and there was a risk of losing all his money.

3.8 The fact that the complainant signed a document confirming that the risks were explained is not sufficient. At all times the Appellant still had a duty to align this risk with the complainant's circumstances. In advising the complainant invest in a failing company is not only negligent but was blatantly reckless.

4.

C. THE EVIDENCE

The Appellant's submissions

The Appellants in their grounds of appeal demonstrated how the Ombud erred in her findings which *inter alia* were the following:

4.1 That at all relevant times the complainant understood that this was a high risk investment and that it constituted a venture capital investment. The complainant sought a single need investment. He did not just sign the client advice record but clearly understood what the nature of the investment was. The Appellant had factually established what the complainant's risk tolerance was as well as his needs.

4.2 Furthermore, at the time the recommendation to invest in this product was made, the financial circumstances in respect of Edwafin were not known to the Appellant.

4.3 At the time the complainant was advised on the product, the debenture company was involved in various ventures, it was an established legal entity and the

debentures were legally issued and they complied with all the requirements set by the authorities.

4.4 The Appellant was requested by the complainant to find an alternative type of investment. He indicated that he did not want to invest in the safe, classic assurance type vehicle.

4.5 The proper due diligence in respect of the investment was performed by the Appellant. Not only was the Appellant duly mandated to sell the debentures in respect of this investment but they were duly authorised to do so by the FSB. This product was a recognised investment product and the Appellant was a recognised financial service provider who could sell this product.

4.6 The Appellants furnished evidence indicating that the complainant was *au fait* with the product and much was made of the fact that the Ombud based her findings on the probabilities and not evidence.

5.

At this juncture the panel further takes cognisance of a response dated 25th May 2010 where the Appellant, upon receipt of the complaint, clarified the product and indicated the following that:

5.1 He had met with several brokers who were successfully marketing the Edwafin products for at least 7 to 8 years and had satisfied clients;

5.2 He had been introduced to various representatives and attended the launches held by the company;

5.3 He himself had several clients investing in this product and they were all satisfied;

5.4 He was aware that Edwafin had business interests in Australia and was negotiating with the mining industry to supply vehicles for underground use;

5.5 He had ensured that he worked with a representative who had sufficient knowledge regarding the product;

5.6 He had also contacted certain investors who confirmed that the investment performed very well and that they were satisfied;

5.7 He further requested confirmation from Edwafin that the company was acting legitimately and in compliance with the law.

6.

As alluded to above, the Appeal Board is obliged to make a decision on the written evidence, the factual information and documentation which was submitted to the Ombud in connection with this matter at the time when she had made her determination.

7.

It is common cause that the Appellant was a broker for the complainant for at least 8 years. The complainant's policy was maturing and he wanted to pay the proceeds into his bond in respect of his house. The Appellant advised him to invest it in Edwafin and Sharemax in equal proportions. He would earn at least 20% on his returns.

8.

Complainant's evidence

Despite the voluminous record, the complainant's evidence is somewhat limited in the record.

8.1 The complainant in his complaint stated that the broker gave him an impressive picture of a company and he bought shares for R200 000.00 due to the advice of his financial broker.

8.2 Having regard to the "client advice record" the following was recorded:

8.2.1 that he wanted to reinvest the proceeds from his mature investment policy into unlisted securities, namely Edwafin and the Sharemax investments;

8.2.2 it was further recorded that there was a risk attached to the capital investment and that he did not want to accept the assurance company products but was looking for high paid returns and prepared to take the risks attached;

8.2.3 Mr Mohanlal signed the "client advice record" on the 16th October 2008 which was subject to a declaration that he understood the product that he was investing in.

8.3 However, in his complaint to the Fidelity Fund Insurance of Edwafin, he stated otherwise in his letter

"I hereby demand a refund of my investment based on the fact that Edwafin did not provide me with a valid prospectus at or prior to the sale and as a result I was not given the opportunity to make an informed decision regarding the investment. It would appear that Edwafin misrepresented the fact regarding the financial situation to my broker, thus misleading me to purchasing this product."

8.4 In a subsequent letter dated 8 December 2010, the complainant advised the FAIS Ombud namely that:

- his broker advised him and gave him the advice to invest in this product and he relied on his broker and trusted him;

- the broker did mention the risk but he was amazed that within a month of investing in the product, the company was in serious financial trouble. The complainant further commented that this is a reflection that the broker did not do sufficient homework on his part.

9.

The Ombud's response to the appeal in respect of the second determination.

In response to the appeal in respect of the second determination the Ombud's response was the following:

9.1 In respect of due diligence undertaken by the Appellant, the Ombud concluded that there was no indication that the Respondent conducted a proper due diligence to satisfy himself of the suitability and viability of the Edwafin Investment Scheme.

9.2 He satisfied himself by merely attending official launches and presentations.

9.3 There was a duty on the Appellant to have conducted a check on the investment scheme and its entities which could have been done by going through the relevant documents which should have shared light on the liquidity of the companies (referring to financial statements).

9.4 There was no indication that the Appellant sought to establish whether any of the Edwafin entities had issued any financial statements.

9.5 The Appellant failed to make an independent and objective assessment of the Edwafin product. All of his efforts appear to have been superficial enquiries, and basic due diligence was not conducted.

9.6 He failed to carry out a basic analysis of Edwafin's financial statements and he particularly failed to enquire how such an extravagant return was possible and viable.

9.7 The Ombud found, on the probabilities, that although the record of advice referred to the fact that the client rejected assurance company products and that the complainant was prepared to take the risks attached, the consequences were not fully explained to the complainant.

9.8 Moreover the "client advice record" was completed by the broker and not by the complainant and he merely signed the document.

9.9 The Appellant was expected to have recommended investments that were consistent with the client's risk profile. What the Appellant did was merely comply with the procedural aspects without conducting a proper risk analysis. The Ombud further states that the Appellant's actions were influenced by the commission that was promised to him which was a total amount of 6% of the investment.

10.

The Appellant had referred the panel to a matter that had been adjudicated before this Appeal Board by his Lordship Justice Howie ***D and T Ludewig vs JC van der Merwe and Johan C van der Merwe Makelaars BK – FOC 661/05/6P*** *... where it was stated:*

> ***"Clearly the entire investment was exposed to loss. That was inherent in the nature of the investment. It was one which Appellant should not, in our***

view, have allowed her to venture. In doing so, he failed to act as a reasonably careful financial service provider. The possibility of such loss in the ordinary cause of forex trading was reasonably foreseeable. It follows that the Ombud was right to find it was negligent in placing the residue of the Gain Capital Investment in LSF."

"However, the law requires that for compensation for negligently caused harm to be awarded, there must not only be a factual causal or link between the negligence and the harm but also causal link recognised by law."

"..... the question, then, is whether it was reasonably foreseeable that LSF was being operated fraudulently and whether to the extent sufficient to cause its liquidation or at all."

"The latter kind of loss was not sufficiently connected to negligence to result in there having being legal causation."

"For these reasons he Respondent should not have succeeded before the Ombud and the appeal must be allowed."

"there is no basis for finding in this case a mere breach of ..... caused any loss. <u>The question is whether the advice was bad or negligently given and whether the collapse of the scheme had any concomitant financial loss was causatively connected to the negligence".</u>

(my underlining)

11.

In order to determine at least if the advice was negligently given, the lack of skill or knowledge is not *per se* negligent. It is however, negligent to engage voluntarily in any potential dangerous activity unless one has the skill and knowledge usually associated with the proper discharge of the duties connected with such activity.[2]

12.

In interpreting the meaning of "care and skill", the Appellants were required to act with <u>reasonable care and skill.</u> What is <u>reasonable</u> in the circumstances is measured against

"general level of skill and diligence possessed and exercised at the same time by members of the branch of profession.[3] To act negligently means to act in a way that falls short of the standard of the reasonable person."

[2] Durr v ABSA Bank 1997 (3) SA 448 at 452.
[3] Durr v ABSA Bank 1997 (3) SA 448 at 461.

For the Appellants to be negligent it must be established that they acted differently from the reasonable person in their profession.

13.

13.1 Negligence is defined in the Dictionary of Legal Words and Phrases, second edition, RD Claassen, LexisNexis, 1997 pgs N-16 as follows:

> ***"The term negligence as used by our courts simply means a failure to exercise that degree of diligence which the law requires under the circumstances of ..... whether the person whose conduct is under investigation is a specialist or an ordinary person the fact remains that diligence required of him is what reasonable specialist or reasonable men would exercise under similar circumstances."***

13.2 In Hammerstrand v Pretoria Municipality 1913 TPD at p 377 De Villiers JP stated:

> ***"Negligence is the failure or omission to take proper care and proper care with which according to our law, a diligens paterfamilias ..... a prudent reasonable man would take under the circumstances such a case. The law presumes that a person exercises on a calling or does any particular act or exercise at calling or do that act with skill, with knowledge and any dangers connected with that calling, to act, that he will take all reasonable precautions to guard others against danger."***

14.

The Appeal Board would only interfere with the Ombud's decision, if it was not exercised judicially, that is if the functionary failed to bring an unbiased judgment to bear on the issue, did not act for substantial reasons, exercised her discretion capriciously or exercised her discretion upon a wrong principle or as a result of a material misdirection.[4]

See also: Mitchell v Dixon 1914 AD at p525; Poultney v ABSA Brokers (Pty) Ltd & Another 2004 JOL 13298E

[4] Malan & Another v Law Society v Northern Provinces 2009 (1) SA 16 SCA, paragraph 13.

15.

In our view, we find that the Appellants had not acted reasonable as what would have been expected from a reasonable member in their specific profession. In the circumstances of this matter, they fell short of what a reasonable, prudent broker would have done. They were aware that the investment did not guarantee them their capital in the event of negative circumstances prevailing.

16.

Even though the complainant sought a high return investment, did not wish to invest in the normal assurance product, was aware of the risks, was aware of the information contained in the "client advice record", had a copy of the prospectus, the Appellants were aware that there was a possibility of him losing his capital and should have steered away from the product. It is obvious that the complainant had no intention of losing his investment in total, and this was an inherent characteristic of the product in question. This factor should have been considered even if it was a "single need investment".

17.

However, as alluded to above, there must further be a causal link recognised by law. This enquiry entails whether it was reasonably foreseeable that the Edwafin product was a fraudulent scam and that the entity was to be liquidated. I find the test in the D and T Ludewig matter instructive.

18.

The Appellant's version in this regard has credence. It is accepted that the Appellant had no knowledge of the fraudulent directors of the entity and was not aware that it was placed in liquidation. Cognisance is taken of the Appellant's knowledge in respect of the

research his interaction with Edwafin, as well as the types of products they were marketing. The panel further notes that the Appellants were also taken by surprise when they discovered that the investment failed to pay its investors and reported them to the SAPS.

19.

The Ombud's finding that the investments had already been in danger and on its way downhill at the time of the recommendation and the investment was made is not supported by evidence. The only evidence before us are some newspaper clippings in 2010 which made reference to the demise of the entity.

20.

Cognisance is taken of the satisfaction of other investors, the payment of high returns to these happy investors. It is accepted that at some stage this was a high paying lucrative investment. Surely the failure of such an investment could not have been reasonably foreseeable, moreso that it was operating fraudulently and was subjected to liquidation.

21.

C. COSTS

Insofar as the issue of costs are concerned, the Appellant requested that the Respondent should be liable for costs. Mr Mohanlal has persisted in his complaint which caused the Appellant to justify its conduct before the Ombud and before this panel on two occasions. The litigation has dragged on unduly for over 5 years. It is noted that this matter has been subjected to extensive litigation with all the parties succumbing to long hours of preparation. We also note the legal issues raised in this matter, the nature of the investment and that although the complainant is fully *au fait* with investments, that

he is no expert in the investment industry and in respect of the product recommended to him. However, our findings are also not in favour of the one party only. In light of the aforementioned, we deem it appropriate that each party be liable for their own costs.

D. THE ORDER

The following order is made:

1. The Appeal is upheld;

2. No order as to costs.

DATED AT PRETORIA ON THIS 9th DAY OF DECEMBER 2016.

PP

ADV H KOOVERJIE SC

CHAIRPERSON

PP

MR MAKHUBELA

MEMBER

MR Z MABHOZA

MEMBER