

APPEAL BOARD OF THE FINANCIAL SERVICES BOARD

CASE NO: FAB4/2016

In the application between:

MARK ALEXANDER INVESTMENTS CC

First Appellant

MARK ALEXANDER EISERMAN

Second Appellant

And

GAIL COLLEEN SHEEL

Respondent

DECISION

1.

A. INTRODUCTION

This is an appeal of the decision of the FAIS Ombud dated 16 February 2016 wherein she upheld the complaint.

The issues on appeal for determination are:

- whether the FAIS Ombud had jurisdiction to consider the complaint. In other words, was it a complaint as envisaged in terms of the FAIS Act (Financial Advisory Intermediary Services) 37 of 2002?
- if so, then had the Appellant conducted himself in terms of the relevant provisions of the General Code of Conduct and the FAIS Act?

2.

B. BACKGROUND

The facts essentially turn on the complainant investing R1 Million in a hedge fund investment known as RVA Fund of the Abante Group (Abante) which turned sour due to the fraud committed by the mastermind of Abante, a certain Mr Pretorius ("Pretorius").

3.

The Respondent's version is that she invested in this investment on the advice given by the Appellant. For the purposes of this decision, Mr Eiserman would be referred to as the Appellant.

4.

The Respondent specifically raised the following in her complaint that:

- 4.1 She was not furnished with a detailed record of the discussions between her and the Appellant;
- 4.2 She received no written advice of any commission paid;
- 4.3 She was refused a copy of the "partnership agreement" pertaining to the investment;
- 4.4 She was advised that the investment performed well and was a safe investment.

5.

The Appellant's version

The Appellant presented *inter alia* the following version:

- 5.1 Various investment options were discussed with the Respondent, which included assurance related investments as well as fixed investments. At a later stage the Appellant had advised the complainant of an investment in hedge funds as she enquired alternative investment options.
- 5.2 The decision to invest in the hedge funds was solely her decision. She particularly made her decision after attending a presentation by Pretorius on the RVAF. In this presentation Pretorius had certainly highlighted the risk in the investment.
- 5.3 When she had made her decision to invest in this investment, he had advised her of the risk implications as well as the fact that he would be earning referral fees.
- 5.4 Her application and the supporting documents thereto were made available to Abante who was responsible to administer the investment.
- 5.5 The Appellant was satisfied that he had conducted the required due diligence, which included having regard to the presentations on Abante. He also took cognisance of the fact that in 2008 it was nominated as the best performing hedge fund in the country.
- 5.6 The Respondent had access to the relevant material which made reference that it was a risk investment. It was Abante that dealt with the hedge fund and should have obtained the necessary authorisation from them.
- 5.7 At all relevant times Abante was the hedge fund FSP. The Appellant's involvement was merely based on a referral and he was remunerated for such referral. He had given no advice as an FSP in terms of the FAIS Act.

- 5.8 Her decision to invest in the RVPF was made after she attended the first presentation given by Pretorius.

6.

The Ombud's findings

The Ombud's findings included *inter alia* that:

- 6.1 The Appellant had rendered advice which was inappropriate;
- 6.2 The Appellant was involved in the entire process in respect of the investment and he even accompanied the complainant to the presentation (second);
- 6.3 The Appellant failed to exercise due diligence skill and care as contemplated in Section 2 of the General Code of Conduct;
- 6.4 The Respondent relied on his advice and which advice induced her to invest in the fund in issue.
- 6.5 The Appellant made no independent analysis of the investment. He merely relied on the presentations made by Pretorius and his team. The Appellant specifically made no attempt to consider the financial statements of Abante.
- 6.6 The Appellant had sold and actively promoted Abante/RVPF and in so doing, he rendered advice.
- 6.7 The Ombud maintained that the investment was one that was considered to be a "financial product" as envisaged in terms of the FAIS Act.
- 6.8 At all times the Appellant was her financial advisor and it was his responsibility to understand the risks in the product and advise client accordingly, since the product supplier ("Abante") would not have made the Respondent aware and more specifically that she could have lost all her money in this investment.
- 6.8 At all times it was a financial advisor who should have given appropriate advice and undertaken a diligent assessment of the product.

7.

C. ANALYSIS AND FINDINGS:

It is settled law that the Ombud derives its authority to adjudicate complaints by virtue of Section 20(3) of the FAIS Act and more specifically in respect of the Rules

on Proceedings of the Office of the Ombud for FSPs, 2003 ("The Rules") which define the type of complaints justiciable by the Ombud. Only if such complaints fall within the ambit of the Act and the Rules, may the Ombud adjudicate thereon. Simply put, only complaints where "advice" is rendered in respect of a "financial product" as defined in the FAIS Act fall within the Ombud's authority.

8.

The Appellant contended that the investment in issue does not constitute "financial product" and moreover the Appellant had not furnished "advice" as defined in the FAIS Act. The "advice" the Appellant rendered constituted factual objective information. Such form of "advice" is expressly excluded as "advice" envisaged in the FAIS Act.

- 8.1 Section 1(3)(a) of the FAIS Act stipulates that factual advice as defined therein cannot be considered to be "advice" in terms of the FAIS Act, namely:

"factual advice give merely

- (aa) on the procedure for entering into a transaction in respect of a financial product;***
- (bb) in relation to the description of the financial product;***
- (cc) in answer to the routine administrative queries;***
- (dd) in the form of objective information about a particular financial product; or***
- (ee) by the display or distribution of promotional material."***

- 8.2 Rule 7(a) of the Rules specifically stipulates that the Ombud must determine whether or not a complaint falls within the ambit of the Act and these Rules and she must reject a complaint which falls outside of the Act.

9.

The nub of the Ombud's findings was that:

"Quite simply, no advisor would have recommended this product as a suitable component of any investment portfolio had they so exercised the required due skill, care and diligence (Section 2 of the General Code). Complainant as a client of a registered financial advisor relied on the Respondent's advice when making this investment. When rendering financial services to client the FSP is required to act in accordance with the Act."

10.

In considering the grounds for appeal, the Ombud reaffirmed her determination and reiterated that her findings based on non-compliance with the Act and the Code were premised on common cause facts or facts which were not disputed by the Appellants.

11.

Before we can consider the aforesaid findings this panel has to firstly determine if the "advice" furnished to the Respondent in terms of the investment was indeed "advice" as contemplated in the FAIS Act.

12.

Section 1(1) of the FAIS Act encapsulates the following to constitute "advice":

"Any recommendation, guidance or proposal of the 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 of any financial product; or

(c) on the conclusion of any other transaction, including a loan or a 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 of such product"

12.1 In order to qualify as advice, there should be some "recommendation", "guidance" or "proposal".

12.2 A "recommendation" is an idea or suggestion that has been put forth to a client with approval as being suitable for a particular purpose. A client is directed to do something with regard to a particular plan of action which is desirable or appealing in some way. Words such as "I advise", "I strongly advise", "I recommend", "I would suggest" are generally used in making a recommendation.

12.3 "Guidance" is normally given in situations where the aim is to resolve a problem or a difficulty.

- 12.4 A "proposal" relates to a situation where a plan or suggestions or ideas are put forward for consideration.
- 12.5 The recommendation or guidance must further be of a financial nature. If a client takes "advice" it would have financial consequences on him or her. However, in the instance of the FAIS Act, it must be "advice" in respect of a financial product.¹

13.

Hence "financial product" must feature in every aspect of the recommendation, guidance or proposal made to the client in order to fall within the FAIS Act. The definition of "financial product" encompasses different types of financial products with sub categories, namely:

- securities and instruments including shares in a company, debentures and other securitised debt, any money market instrument, any instrument relating to the rights to subscribe, acquire, dispose of or convert any shares, debentures, money market instrument or other securitised debt, any securities as defined in the Security Services Act 2002;
- any unit trusts;
- any long or short term insurance contract or policy;
- any benefits provided by a pension fund organisation or friendly society to its members;
- in foreign currency denominated investment instrument including a foreign currency deposit;
- a bank deposit with a term not exceeding 12 months;
- a health service benefit provided by a medical scheme;
- **Any other financial product which is similar in nature to the above products and which is declared by the Registrar of the FSB to be a**

¹ Moolman and others "Financial Advisory and Intermediary Services Guide", LexisNexis pg 197 – 199.

financial product for the purposes of the FAIS Act. Such declaration has been published in the Government Gazette.

- a financial product which contains one or more of the financial products referred to in the definition;
- any financial product issued by a foreign product supplier and marketed in South Africa which is similar in nature to any of the defined financial products.

14.

On this point it is necessary to have regard to the FSB press release dated August 10, 2012 where the FSB clarified its monitoring capacity in respect of investments and in particular Mr Pretorius' business affairs and the products he marketed. The purpose of the statement was to inform the public of the FSB's powers and its limitations in regulating various financial and investment products. It was emphasised that members of the public who invest their savings may or may not be subject to FSB Regulation since it depends on the nature and the structure of the particular investment vehicle. It was further highlighted that certain types of investments would not be subject to FSB Regulation namely:

- 14.1 A partnership where individuals invest their monies in a partnership and utilise the capital to produce positive returns;
- 14.2 An investment club where persons with a commonality of interest pool their monies to make an investment;
- 14.3 A company formed for investment purposes in which investors obtain equity;
- 14.4 A trust in which beneficiaries' monies would be pooled, but which would fall outside the ambit of Collective Investment Schemes Control Act, due to the nature of underlining investments, or because it is a private arrangement between persons involved in a private business arrangement.
- 14.5 It was also highlighted that certain investments may not always involve a financial product as contemplated in terms of the FAIS Act. For instance, if one becomes a member of an investment club or a beneficiary of a trust, it is not an acquisition of a financial product by the investor even though the monies invested may be used by the investment vehicle to acquire a financial product; for example, a share or derivative instrument. (The latter being typically the type of products in which hedge funds invest).
- 14.6 A further aspect to have regard to is the manner in which investors are attracted. The ambit of the FAIS Act is focussed on the rendering of financial services which typically involve three parties, namely a product

- supplier, an intermediary and a client. Unless a “financial product” is involved, the FAIS Act does not apply. Whilst product suppliers may be required to be authorised under the FAIS Act when giving advice relating to their products, the selling of such products by a product supplier directly to the public may not amount to an intermediary service.
- 14.7 Even though the selling of unlisted shares may constitute financial services contemplated by the FAIS Act, the FSB had followed up on the information in respect of Pretorius’ business affairs and found that these activities did not require FAIS licence at the time and the FSB was satisfied that the private equity and the venture capital products embarked upon or supported by Mr Pretorius did not constitute an activity which was subject to FSB regulation.
- 14.8 The FSB further established the manner in which Pretorius indicated that capital would be raised from investors and the investment vehicle used for the raising of such capital also did not point towards an activity which was subject to FSB regulation or otherwise unlawful because:
- Pretorius was acting as the principal (product supplier) and not as an intermediary when acting with potential investments;
 - The investment vehicle as envisaged at the time was a company. The FSB does not regulate the offering of shares in a company to the public. When such shares are offered the company acts as a product supplier and must comply with the Companies Act.
- 14.9 It was reiterated that schemes that are operated outside of and actively in secret from the Regulator cannot be said to be operating under the Regulator’s nose. In all probability this is what had happened with Pretorius’ activities.
- 14.10 Pretorius was certainly operating schemes that were done in strict secrecy from the FSB. The FSB took a stern view that there were certainly fraud and non-compliance on the part of Pretorius and he had designed his schemes in such a way that it was not subject to be regulated by the FSB. This had led to the abuse of investors who were lured into his projects. Rather such investors should have been responsible and they had an obligation to enquire into the merits before parting with their money, particularly where above average returns were being offered.

15.

The Ombud notes particularly that Abante was an investment manager approved by the FSB and it was registered under licence number 874 in 2004. However, the licence was transferred to Polus Capital (Pty) Ltd in 2008. Insofar as the RVA Fund was concerned it is clear that it was not licenced in any way.

16.

The evidence reflects that when the Appellant spoke to the Respondent about an alternative investment option, she was presented with an introduction letter which recorded the type of products that the Appellant was accredited to sell in respect of the various commercial investments which were available at the time and it specifically noted that Abante was one of the products that it was authorised to deal with. Prior to the introduction letter the Respondent was furnished with a letter which generally set out the background of the Abante Group and more particularly the nature and the operation of the Relative Value Arbitrage Fund (RVAF) of the Abante Group.

17.

I highlighted the following portions contained therein that:

- Abante Capital (Pty) Ltd is a South African hedge fund management company and the aim of each of its funds was to achieve ongoing positive returns;
- the hedge funds were not regulated by the FSB in South Africa;
- the Abante Group won the Hedge Fund Manager of the Year Award in the previous year;
- the hedge fund is considered as a low risk fund.

18.

If we further have regard to the nature of this investment, essentially the Respondent had become a partner in the Relative Value Arbitrage Fund *en commandite* partnership. The funds which she invested were placed under the management of an investment manager by the RVAF. The investment portfolio consisted of the purchase of securities. This agreement mandated the investment manager to purchase securities for and on behalf of the client.

19.

The parties had also agreed by virtue of the "investment management agreement" that the fund shall make available to the investment manager all its assets from time to time to be invested in securities managed by the investment manager in accordance with the hedge investment strategy and the fund Charter. The investment manager was given a mandate to utilise the invested funds to invest in securities or otherwise be utilised in the entire discretion of the investment manager in accordance with the fund Charter, which included buying and selling securities,

borrowing money or securities or otherwise utilising investment funds in any way whatsoever which is consistent with the investment manager's head investment strategy.

20.

Hedge Fund FSB

The Registrar of the Financial Services Board in board notice 89 of 2007 defines a hedge fund FSP as follows:

20.1 Hedge Fund FSP means a financial services provider:

- (a) that renders intermediary services of a discretionary nature in relation to a particular hedge fund or fund of hedge funds in connection with the particular financial product referred to in the definition of administrative FSB.

In sub-section 2.1 of Section 2 of Chapter (i) of this Schedule and

- (b) acting for that purpose specifically in accordance with the provisions of the respective codes set out in Chapter (iii) of the Schedule read with the Act, the General Code of Conduct for Authorised Financial Services Providers, 2002 and any other applicable law.

20.2 The Ombud was correct in finding that RVAF was promoted and sold as a hedge fund and the fund not only exercised complete control over the Respondent's monies but carried out all administrative services. The Regulations mentioned above thus apply to Abante and not the Appellant. In this matter, the issue for determination is whether the advice which the Appellant had rendered to the Respondent was indeed advice given in terms of a financial product as envisaged in the FAIS Act?

21.

It is quite clear that in this instance Pretorius had done everything in his power to circumvent the FSB by tailoring the product in such a manner that it fell outside the FSB regulatory rules. It is clear that the Respondent had become a partner in a partnership which partnership invested in various instruments including securities and the mandate in order to do the investment is given to an investment manager who earns a performance fee.

22.

Cognisance is taken of the FSB's press release where the FSB considered the hedge fund product in issue, and found that it fell outside the FSB's regulatory net.

23.

It was therefore not a product that constituted a "financial product" as defined in Section 1(1) of the FAIS Act. There is no doubt that the Appellant had recommended the product. However, the following enquiry is crucial:

23.1 Was it objective factual advice?

23.2 Was it advice in terms of a financial product?

24.

The FSB confirmed that Pretorius was acting as a product supplier (principal) when interacting with potential investors.

25.

The complaint in issue does not concern a "financial product" in terms of the FAIS Act and this falls outside the ambit of the FAIS Act and the Rules. The FSB had expressed that the RVAF falls outside its regulatory net.

26.

At this juncture, the panel need not make a conclusive finding on the extent of the advice given by the Appellant. The Appellant maintains that it was factual objective advice. Consequently this Appeal Board has no authority to review a decision which should not have been considered and dealt with by the Ombud. This Appeal Board is also a creature of the FAIS Act. It may perform no functions and exercise no power except that conferred upon it by law.

27.

It is therefore not necessary to deal with the rest of the issues in dispute. The Respondent's remedies lie in launching an application to the High Court and FSB has encouraged investors like herself to do so and she should pursue such process. The dispute should therefore be dealt with in the appropriate forum where the Court should be apprised of all the facts in this matter.

28.

We deem it appropriate that there be no order as to costs in light of the nature of the matter and the legal dispute raised.

29.

In the premises the following order is made:

1. The appeal is upheld.

DATED AT PRETORIA ON THIS 22nd DAY OF NOVEMBER 2016.



ADV H KOOVERJIE SC
CHAIRPERSON



MR J PEMA
MEMBER



ADV W NDNISA
MEMBER