IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 05123/12-13/ FS 1

FAIS 00777/12-13/ FS 1

In the matter between:

YOLANDE HAMMAN **Complainant**

and

KOBUS EAGER **Respondent**

DETERMINATION IN TERMS OF SECTION 28 (1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT 37 OF 2002 ('FAIS ACT')

A. INTRODUCTION

[1] This determination follows a recommendation made in terms of section 27 (5) (c) of the Act on 7 November 2017.

[2] The recommendation upheld the complaint of inappropriate advice and found that a sufficient link between the inappropriate advice and the loss suffered by the complainant existed. The respondent did not accept the recommendation

B. THE PARTIES

[3] The complainant is Mrs Yolande Hamman, an adult female whose full particulars are on file with this Office.

[4] The respondent is Mr Kobus Eager, an adult male sole proprietor whose address according to the Regulator's record is 18 Thompson Street, Bethlehem. The

respondent is an authorised financial services provider (FSP) with licence number 7145. The license has been active since 3 September 2004.

C. THE RESPONDENT'S REPLY TO THE RECOMMENDATION

[5] As previously mentioned, the respondent did not accept the recommendation. However, instead of dealing with the actual dispute (the issues surrounding the advice rendered), the respondent, with the assistance of his attorney raised unsubstantiated points of bias, lack of fair process and an infringement of constitutional rights.

[6] The aforesaid arguments are not new to this Office and have been raised *ad nauseam* by the respondent's attorneys in other matters. In a ruling[1] of the Financial Sector Tribunal (the Tribunal) following an application for leave to approach the Tribunal, the deputy chairperson had the following to say:

"The time has unfortunately arrived to inform the instructing attorney that too many of the applications that emanate from his office are, prima facie, vexatious and amount to an abuse of process. The issues raised in this application have nearly all been raised in previous applications and appeals - unsuccessfully. The applications are on a template and more often than not deal with generalities and not with the particular facts of the case.

The application is dismissed".

[7] The aforesaid should put to rest arguments that does not take a matter further. The remainder of the respondent's reply (which is largely a repetition of points raised previously) are where applicable, dealt with below:

[1] *Koch & Kruger Brokers and Others v DS van Rooyen and the FAIS Ombud* FAB40/2018

No complaint provided

[8] The respondent alleges that he had not been made aware of any claim under reference number FAIS-00777-12/13 and are therefore unable to respond to it.

[9] This allegation is simply incorrect, as the two reference numbers noted in the file of papers relates to the two investments made the complainant in respect of herself, and on behalf of her minor daughter. The respondent dealt with both investments in his response to the rule 6 (b) letter, and can therefore not claim that he was not aware of the complaint.

[10] As pointed out in the recommendation, the respondent had ample opportunity to resolve the matter with his client, but elected not to do so. It is therefore disingenuous to now claim that he was not aware of the complaint against him.

[11] The respondent also claimed that this Office merely chose the version of the complainant over his. This is simply not true. Just because this Office did not draw the conclusions the respondent desired, does not mean that his version or documents were ignored.

Complainant's profile

[12] The respondent pointed out that at the time of making the investment, the complainant was a "highly intelligent graduate professional with a senior managerial employment position". Owing to the aforesaid, she had many productive years ahead of her to earn an income, and the investments were single needs. Furthermore, the investment funds was a portion of her share to divorce proceedings and did not constitute pension money or savings.

[13] It is not clear how these statements assist the respondent's case. It certainly does not mean that the respondent had a lesser obligation to observe the provisions of the Code when rendering the advice. The fact that the complainant is a graduate professional,

does not make her proficient in the financial sector. It is furthermore irrelevant what the source of the funds were. The fact remains that in the complainant's peculiar circumstances, she could not afford to lose the money she wanted to utilize for her child's education and that she was preserving to buy a house.

Single need

[14] The concept of a "single need" is not defined anywhere in the Act or the Code, yet is repeated over by FSP's. The respondent admitted to rendering advice, and therefore section 8 of the Code applied, regardless of the needs expressed by the complainant. In fact, the provisions of section 8 (1) is peremptory. The respondent was handsomely rewarded by means of the commission he received on the respective investments, and therefore had to ensure that the product he recommended was suitable for his client's needs and circumstances.

Risk

[15] The respondent relies on the fact that the complainant received a prospectus, and signed documentation which confirms that the risks were explained to her. The allegations raised by the complainant, in the respondent's view, are therefore contradicted by the documents she signed. In this respect, the respondent raises the issue of *pacta sunt servanda*[2] and *caveat subscriptor*[3]

[16] These arguments however are misplaced. The complainant is not disputing the validity of the contracts entered into to make the investments, but rather the appropriateness of the advice that persuaded her to conclude the said contracts.

[17] A signature by an investor does not equate to an understanding of the risks in the investment, and that a person was willing to invest from a position of being able to

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2 The common law principles that agreements are binding and must be enforced.

3 Suggests that a person who signs a contractual document does by his signature assent to the contents of the document, and if the contents turn out not to be to his liking he has no one to blame but himself.

make an informed decision. The client questionnaire dealing with the risk assessment contains a set of irrelevant questions and does not specifically inform the investor that there is a risk of losing all her funds.

[18] The test here is whether or not the respondent provided the complainant with adequate and appropriate advice wherein the considerable risks in the syndication products were explained to her. The complainant relied on the respondent's expertise in this regard. However, the respondent can only refer to the Sharemax prospectuses, disclosure documents and application forms. There is no independent record of advice which shows that the respondent made full and frank disclosures to the complainant as required by section 7 (1), so that she could make an informed decision.

[19] This Office maintains its position that the respondent himself did not appreciate the risks inherent to these investments. The respondent has not noted anywhere that he informed the complainant that, in respect of both investments, she would be lending her money to companies that did not own properties yet, and that the money would be lent to developers to build the properties. In return for these investments, she would have a "claim", which is defined in the Sharemax prospectuses as an "*unsecured subordinated floating interest rate acknowledgement of debt made by the company in favour of the shareholder".* In other words, what the complainant acquired, are nothing other than debentures[4].

[20] The respondent's claims that he provided the complainant with alternative investments options, are also not supported by any documentary evidence or a record of advice.

[4] A debenture is used by companies to borrow money, at a fixed rate of interest. The debenture is a document that either creates a debt or acknowledges it. A debenture is a certificate evidencing the fact that the company is liable to pay a specified amount with interest. Although the money raised by the debentures becomes a part of the company's capital structure, it does not become share capital.

Section 311 compromise

[21] It is not disputed that since the respondent stopped receiving payments of her returns on the Zambesi investment, no further funds were received. Furthermore, despite the maturity of the Berg en Dal investment, the complainant has not received her capital back. The respondent provided no justification for stating that there is still realisable value in the Sharemax investments.

[22] I also refer to communication issued by the Nova Property Group[5]. During October 2015, the group reported that the Berg en Dal project will only be launched during 2016. Several approvals from the municipality appeared to be outstanding at the time. Nothing much has been reported on the development since then. In respect of Zambezi, it was reported during March 2017 that litigation is ongoing and very complex. In neither of the aforesaid, there seems to be any prospect that investors will receive their funds.

The King Code

[23] The respondent claimed that the King III report was not available when this investment was made, and that the King Code does not apply to Sharemax as it is not a listed company. This may be so, but the respondent missed the point. The reference to the King Code[6] was to highlight failures in corporate governance which exposed investors and shareholders to risk, as there was no independent board of directors in the entire Sharemax group, nor was there independent audit, risk and remuneration committees.

[24] The directors of Sharemax Berg en Dal (into which the respondent's investment was paid) were the same as Amber Sunrise Properties 99 (Pty) Ltd (the developers) and Sharemax. Sharemax also assumed all of the following roles: promoter, company secretary, transfer secretary and manager of investor funds. Investor funds were at risk

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5 Please see the letters on www.frontieram.co.za

6 The King Code first came into being during 1994, and has therefore been in existence for a number of years. At the time, King II was applicable and the reference to King III, was probably owing to a typing error.

the moment it was paid into the trust account of the attorneys. The complainant should have been made aware of this. On the respondent's own version, he conducted due diligence on the investment before recommending it to the complainant.

The Sharemax model and the Experts

[25] The respondent's attorney, as is customary, quoted "expert" opinions and attempted to discredit this Office's analysis of the Sharemax model. These points have been dealt with in detail by this Office before, and considered by the Tribunal. I do not intend to deal with it again. Instead I refer to the judgment of Daffue J, in the matter of *Oosthuizen v Castro*[7] where the following was noted:

At paragraph [53]:

"…….according to the pleadings defendant admitted informing plaintiff that she did not have to be concerned as he had spoken to Sharemax as well as his consultant. This was not good enough. Defendant should have spoken to independent auditors, attorneys or financial analysts. He should have insisted on financial statements, such as income and expenditure accounts, cash flow analyses and a balance sheet. He should have inspected the shopping complex. If he did that, he would know that the investment could not possibly have an income stream at that stage or even in the foreseeable future". (my emphasis)

At paragraph [54]:

"…….Mr Heystek[8] explained the potential dangers of property syndication and also made the point that insofar as the companies involved were unlisted, there was a lack of disclosure making it difficult for financial analysts to make meaningful comparisons.

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7 2858/2012, High Court, Free State Division

8 Mr Magnus Heystek, an eminent business and investment journalist and investment strategist, gave expert evidence in respect of several aspects; in particular whether the conduct of defendant complied with that which could be expected of a financial advisor in the circumstances, and if not, what type of investment a reasonable financial advisor ought to have suggested in the circumstances.

Accordingly, as testified to by him, a FSP "should not advise an investment in something which he is not himself able to fully understand."

[26] In paragraphs [55] to [60], the following is important:

" [55] Mr Heystek mentioned that defendant clearly did not explain the risks and pitfalls of property syndication to plaintiff. According to his experience properties are often sold at high valuations to the companies that form the vehicle for property syndications, allowing the promotors to make huge profits upfront. High marketing costs and commissions are paid, whilst the income stream from the underlying assets might be unpredictable and uncertain.

[56] In casu several financial journalists and others warned investors over a prolonged period. Defendant, having been aware of the criticism, should have either himself investigated the reliability of the investment or made enquiries from independent and reliable sources. It is amazing that defendant could think for one moment that interest could lawfully accrue from the investment from the first month. I wonder where he thought the magical origin of the income stream would derive from. No doubt, a simple investigation or even an inspection of the half-built shopping complex would have been an eye-opener. He should have realised that enormous costs would have to be incurred to complete the project…….. The half-built shopping complex could not earn any income for some time – it was obviously dependent on being completed, the signing of lease agreements and eventual and actual occupation by tenants – but the investment provided for income to be paid to investors from the start. This is apparently what defendant believed would happen. (my emphasis).

[57] I agree with Mr Heystek's testimony that all initial payments – at least until income is eventually received from tenants - would have to be paid out of funds put in by investors themselves. Investors therefore paid their or other investors' interest. There were no other sources of income during the construction phase of The Villa. The underlying property – the half-built shopping complex could not produce income on a

monthly basis as investors and plaintiff in particular expected. Defendant was in breach of his fiduciary duty towards plaintiff in that he did not take reasonable steps to satisfy himself of the safety of the Sharemax investment. I am also in agreement with Mr Heystek, accepting the ruling in 2013 of the Ombud for Financial Services, Ms Bam, that The Villa "bear uncanny characteristics to a so-called Ponzi Scheme."

[58] If the totality of the evidence is considered, defendant should have seen the red flashing lights, but not only that, he needed to heed and advise plaintiff differently. Defendant offered wrong and unsuitable advice to plaintiff, either through incompetence and/or ingenuousness and/or negligence, or for the lure of a small fortune. It is common cause that he earned a commission of R120 000.00 for an afternoon's effort. This is an enormous amount of money and not market-related. It is a well-known phenomenon that promotors in these types of schemes make use of high commissions to attract brokers and so-called financial advisors to do business…….. <u>His inexplicable, but obviously poor advice is indicative of lack of skill, care and diligence and did not commensurate with the commission received.</u> The parallels between the facts in casu and those in Durr are remarkable.

[60] Much more may be said of the defendant's actions and/or inactions, but I conclude by finding that defendant was negligent, and even dishonest, when he advised plaintiff, by placing no credence on the negative articles in the press and failing to objectively investigate the criticism. He failed to exercise the degree of skill, care and diligence which one is entitled to expect from a FSP".

[27] I also refer to the judgment of the former Appeals Board in the matter of *CS Makelaars*, paragraphs 31 – 41 where Harms J dealt with the structure of the Zambezi and Villa investment. The Board accepted that investors were paid out of their own funds and that their funds were used to make an unsecured loan to the developer.

D. FINDINGS

[28] On a balance of probabilities, it is unlikely that the complainant would have agreed to invest if the risks were disclosed to her. The complainant repeatedly stated that she had reservations about the Sharemax investments, to the extent that she opted for an investment with Standard Bank. It was only because of the continued reassurance of the respondent (aided by Mr Hertzog of Sharemax) of the safety of the investments, that the complainant changed her mind.

[29] Disingenuously however, the respondent tried to absolve himself from responsibility by claiming that the ultimate decision to invest, was a result of the intervention of Mr Hertzog. The complainant did not have an agreement with Mr Hertzog to render advice, but with the respondent. He was therefore obliged to observe the Act and Code.

[30] On the facts before me, I find as follows:

30.1 The respondent, in providing financial advice, failed to provide his client with information that was factually correct.

30.2 He failed to provide information about the product that was adequate and appropriate.

30.3 The respondent failed to provide full and frank disclosure of information to the complainant to enable her to make an informed decision.

30.4 He failed to ensure that his client invested in a product that was appropriate for her needs and consistent with her tolerance for risk; and

30.5 The respondent failed to take reasonable steps to ensure that the complainant understood the advice and was in a position to make an informed decision.

[31] In the premises I find that the respondent also contravened the following sections of the General Code: Sections 3 (1) (a) (i) and (iii); Section 7 (1) (a), Sections 8 (1) (c) and (2), and Section 9 (1).

E. THE ORDER

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

1. The complaint is upheld.

2. The respondent is ordered to pay the complainant the combined amount of R310 000.

3. Interest on this amount at a rate of 10% per annum from the date of determination to date of final payment.

4. The complainant is to cede her rights in respect of any further claims to these investments to the respondent.

5. The matter should be referred to the Financial Sector Conduct Authority (FSCA) Enforcement Department for consideration in respect of the breaches of the FAIS Act and the Code.

DATED AT PRETORIA ON THIS THE 15TH OF AUGUST 2018.

NARESH S TULSIE

OMBUD FOR FINANCIAL SERVICES PROVIDERS