FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS 09229/10-11/ KZN 1

23 November 2017

MR BE GRIFFITHS

MIDCOAST FINANCIAL SERVICES (PTY) LTD

Per email: bgriffiths@midcoast.co.za

Dear Mr. Griffiths

Alma Cathrine O'Grady and Patrick Richard John Dewes in their capacity as executors of the Estate Late Mr John Michael O'Grady V Midcoast Financial Services (PTY) Ltd (first respondent) and Bruce Earl Griffiths (second respondent): RECOMMENDATION: IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT (37 of 2002)

A. INTRODUCTION

1. On 22 February 2011, Mr. John Michael O'Grady (the "complainant") filed a complaint with this Office against Midcoast Financial Services (PTY) Ltd and Bruce Earl Griffiths, (collectively referred to in this recommendation as the "respondent"). The complaint arose from a failed investment made by complainant, on respondent's advice, into Sharemax The Villa Retail Park Holdings Limited (The Villa Ltd), a property syndication scheme promoted by Sharemax Investments (Pty) Ltd, (Sharemax).

Delays in finalising this complaint

2. Sometime in September 2011, after the Office had issued the *Barnes* determination[1], the respondent in that matter brought an urgent application to set aside the determination[2]. Before the fate of the application could be known, respondents sought an undertaking from this Office that it would not proceed to determine any other property syndication related complaints involving them.

[1] See *E Barnes v D Risk Insurance Consultants* FAIS-06793-10/11 GP 1

[2] Respondent claimed that section 27 of the FAIS Act was unconstitutional

Sussex Office Park, c/o Lynnwood and Sussex Avenue, Lynnwood, 0081
P O Box 74571, Lynnwood Ridge, 0040
Phone: (012) 762 5000 / (012) 470 9080; Fax: (012) 348 3447 / (012) 470 9097
www.faisombud.co.za

3. Since no legal basis was provided for respondents' demands, the Office proceeded to determine further property related complaints, involving the respondents. In reply, respondents launched an urgent application for an interdict to stop the Office from filing the determinations in court, until the main application had been disposed of. The decision in the main application was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[3].

4. Following the decision of the High Court, which essentially dismissed the respondent's application, the Office continued to determine complaints involving property syndications. However, in 2013 following the *Siegrist* and *Bekker* determinations[4] and the relevant appeal, a decision was taken by the Office to halt processing property syndication related complaints. The decision was not taken lightly, but it was a necessary risk management step. In both determinations, the Office sought, for the first time, to hold the directors of property syndication schemes liable for complainants' losses. The said appeal was finally decided in April 2015[5], after which the Office resumed processing complaints involving property syndications with due regard to the decision. As many as 2000 (mainly, property syndication related) complaints had to be shelved pending the decision of the Appeals Board.

B. THE PARTIES

5. Complainants are Alma Cathrine O'Grady and Patrick Richard John Dewes, in their capacity as Executors of the Estate late Mr. John Michael O'Grady[6].

6. First respondent is Midcoast Financial Services (Pty) Ltd, registration number 2000/006698/07, duly registered in terms of South African law. The Regulator's records indicate first respondent's last known address as 20 Hosking Road, Wembley, Pietermaritzburg, 3201. First respondent was an

---

3 Gauteng High Court Division, case number 50027/2014

4 See in this regard FAIS-00039-11/12 and FAIS-06661-10/11.

5 See in this regard the decision of the Appeals Board date 10 April 2015.

6 in terms of the letters of executorship issued by the Master of the High Court dated (31/07/2017) with reference number (005340/2017)

authorised financial services provider with license number 17641. The license lapsed during April 2011.

7. Second respondent is Bruce Earl Griffiths, an adult male sole proprietor and representative of first respondent. The Regulator's records indicate respondent's address as 20 Hosking Road, Wembley, Pietermaritzburg, 3201. At all material times, second respondent rendered financial services to complainant. I refer to first and second respondents as respondent. Where appropriate I specify which respondent is being referred to.

8. It appears from the Regulator's records that Respondent was not licensed to render financial services in connection with unlisted shares and debentures, which are categorised as 1.8 (described in the FAIS Act as Securities and Instruments: Shares) and category 1.10 (described in the FAIS Ac as Securities and Instruments: Debentures and Securitised Debt) respectively.

C. THE COMPLAINT

9. On 18 March 2009, complainant a 74 year old retired veterinary surgeon, sought advice from respondent in respect of investing R500 000, to generate an income during retirement. This amount represented a significant portion of the complainant's entire life savings which totalled R800 000.

10. Respondent recommended an investment into The Villa, a property syndication scheme promoted by Sharemax. The investment was, according to respondent, secure and 'ideal' for complainant's circumstances. Respondent confirmed that the shareholders would own the buildings; in so saying, he intimated that the investment was as secure as investing in fixed property.

11. Complainant signed the application on the same day and the investment incepted on 25 March 2009. Complainant received a monthly income of R4791.67 from April 2009 until August 2010 when all income payments ceased.

12. Since the income from the Sharemax investment ceased complainant was forced to sell his house to take care of monthly expenses, and he was prior to his passing in possession of a money market

account with the remaining proceeds from the sale of his house and he received a SASSA grant of R1 600.00 per month.

13. Complainant believes that respondent was grossly negligent in recommending that an individual, in his situation, invest most of his life savings in a risky investment such as Sharemax. Complainant seeks relief from this Office in the amount of R500 000, the amount invested.

D. RESPONDENT'S VERSION

14. Respondents' response was received on 26 April 2011 following our Rule 6 (b) letter of 14 March 2011. The response is summarised below:

14.1 Respondent began by applying to this Office, in terms of Section 27 (3) (c) of the FAIS Act, to determine that the matter would be more appropriately dealt with by a court and that the Ombud decline to entertain the matter. No reasons for this application were provided.

14.2 Respondent claims that complainant was referred to him by an existing client who was also an investor in Sharemax, and it was mentioned, by the referrer, that respondent could assist complainant with a property portfolio which would generate a higher income than that offered by the banks.

14.3 The response records that complainant had lost a significant amount of money in the stock market and that he only had R800 000 with which to generate a monthly income of R9 000.

14.4 Respondent in its response provided a 'Client Advice Record' that confirms that various options were proposed to complainant which included Bonds, Cash, and Equities. Both bonds and cash were discarded as the projected returns did not meet complainant's income requirements. Equities were also rejected by complainant as a result of the previous losses incurred, and complainant was, as noted in the document 'Not keen due to loss - Citadel', which is a reference to the previous FSP which had experienced significant investment losses.

14.5 In the Client Advice Record, property (not property syndications) was however presented as a possible option, and that after further discussion complainant decided to invest R500 000 with Sharemax and the balance of R300 000 with Momentum in a low risk structure.

14.6 A risk profile was completed for complainant which indicated that he was a conservative investor. The Client Advice Record however, does confirm that complainant's limited capital would not be served by a conservative approach and that income was the highest priority. It is for this reason that respondent recommended Sharemax and the investment into Momentum.

14.7 Respondent claims to have fully explained the risks associated with investing in property syndications, and that complainant was not only provided with a prospectus but that it had been fully explained to him, and he had understood the contents thereof. Despite respondent's reliance on disclosures made in the application form signed by complainant, no documentation has been provided in support of these claims.

14.8 Respondent points to the share certificate furnished to complainant as confirmation that 100% of complainant's funds had been invested, and that the commission of 6% had been paid to him by Sharemax. It is clear from this statement that respondent did not appreciate the manner in which commission was paid, and that this had not been communicated with complainant.

14.9 Respondent denies ever having advised complainant that Sharemax was a safe investment. Whilst the Client Advice Record notes that complainant required a high income and that a more aggressive strategy was required, it is clear in the document that respondent positions Sharemax as a property investment that was less risky than an investment in equities.

14.10 Respondent claims to have first been introduced to Sharemax during 2001/2002 and that it was only once he had satisfied himself that it was a well-structured entity that he began

recommending it to his clients. He refers to the exceptional performance and impeccable track record of Sharemax that not only provided , in his own words, 'phenomenal' results, but that the investor's capital was **protected** (own emphasis), which is why he was happy to recommend Sharemax to his clients. This would appear to contradict the claims made in the point above that he had never advised complainant that this was as safe investment.

14.11 No further details are provided as to any due diligence conducted into the suitability of Sharemax, and the remainder of the response is aimed at fulminating against the Office.

E. INVESTIGATION

15. On 19 September 2016, this Office sent a notice to respondent in terms of section 27 (4) of the FAIS Act, (the Notice) informing respondent that the complaint had not been resolved and that the Office had intentions to investigate the matter. The letter read (omitting what is not material):

15.1 The prospectuses of both the Villa Retail Park Holdings as well as Zambezi…… declare that the respective entities have never traded prior to the registration of the prospectus, have not made any profit whatsoever and are still under construction.

15.2 In the circumstances, how did you expect the income to be paid, other than out of investors' money?

15.3 The prospectuses refer to the investment as being an unsecured subordinated interest rate acknowledgement of debt linked to a share, which share was in an entity still under construction.

15.4 Given the preceding paragraph please advise as to why you considered the investment to be anything less than an extremely risky venture, without any substance to its guarantee on interest payments?

15.5 Was your client properly apprised of these risks? Please provide evidence to this effect.

15.6 What information did you rely on to conclude that this investment was appropriate to your client's risk profile and financial needs? In this regard, your attention is drawn to the provisions of section 8 and 9 of the General Code.

16. Respondent was invited to substantiate his answers with documents compiled at the time of providing advice to his client.

17. Respondent provided a response to the Section 27(4) Notice on 5 October 2016. The response is summarised below:

17.1 Without being specific, respondent pointed that there were material disputes of fact between his version and that of the complainant and that the matter should be referred to court.

17.2 The prospectus of the investment was provided, and explained to, complainant, and he had signed the application form and the certificate titled "Risk Assessment and Product Information".

17.3 Referring to Section 4 of the Sharemax prospectus, respondent made the point that Sharemax promoted each new investment opportunity by way of a new company and that the track record of Sharemax as a promoter illustrated to the potential investor the viability of the investment model.

17.4 The respondent was satisfied that a potential investor would know how the investment was structured and what to expect of the proposed investment companies set out in the prospectus.

17.5 Respondent has referred to hearsay evidence he had extracted from the expert opinion of three witnesses, Mr. Anton Swanepoel a Certified Financial Planner, Mr. Derek Cohen a merchant banker, and Mr. Schussler an economist.

18. I have meticulously perused all three opinions and found no relevance to the questions of advice that were asked of the respondent in the section 27 (4) notice. I note however that one expert, Mike Schussler, an economist, makes the point that the investment in The Villa was high risk and that it is not advisable to have anything more than 5% to 20% of one's net-worth in this type of investment. Cohen's opinion was entirely unhelpful as he commented on two determinations made by this Office. I also found the opinion of Mr. Swanepoel equally unhelpful.

F. ANALYSIS

Disputes of fact

19. I have noted that, in the statements by respondent, there are disputes of fact in this matter. I state however, that apart from making the claim, respondent made no attempt to identify those disputes of fact. In any event, this matter can be determined on the facts which are common cause and on respondent's own version. Furthermore, it must be borne in mind that the Code in section 3 (2) demands that providers maintain a record of all verbal exchanges with the client in relation to the financial service rendered. I have not found such a record in respondent's response.

20. In addition, the Code in section 9 enjoins providers to maintain a record of advice which shall set out the products considered and the product/s recommended to the client, including reasons the recommended product is likely to meet the client's circumstances. The records called for by the Code are not only for the benefit of clients but for the providers rendering financial services. In circumstances such as these, the records would assist the provider.

21. I highlight in the paragraphs that follow that respondent's advice was fundamentally flawed in that the scheme guaranteed neither the investor's capital nor the income payable. If anything, the prospectus of the scheme made it plain that the investment was far too risky and in that case unsuitable to complainant's needs.

The law

22. I deem it necessary to first refer to the relevant parts of the General Code, (the Code).

a. Section 2, part II of the General Code of the Conduct (the Code) states that a provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.

b. Section 8 (1) (a) to (c) of the General Code states that:
"A provider other than a direct marketer, must, prior to providing a client with advice -

(a) take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice;

(b) conduct an analysis, for purposes of the advice, based on the information obtained;

(c) identify the financial product or products that will be appropriate to the client's risk profile and financial needs, subject to the limitations imposed on the provider under the Act or any contractual arrangement…"

23. As a consequence of the breach of the Code, the respondent committed a breach of his agreement with complainant in that he failed to provide suitable advice. The respondent must have known that complainant would rely on his advice as a professional financial services provider in effecting the investment in Sharemax

24. The questions posed in the notices in terms of section 27 (4) sent by this office to respondent had their answers grounded in the prospectus, such that, if respondent had read the prospectus, as he claimed to have done, he would have understood that the investment was not suitable for complainant. I refer in this regard to the attached annexures A1, A2, and A3 being summaries of the The Villa Ltd prospectus, the Sale of Business Agreement, and Government Notice 459, (Notice 459) as published in Government Gazette 28690.

The Villa Ltd

Violations of Notice 459

25. From the onset, paragraphs 3.2 and 3.1.1 of the prospectus make it clear that the directors of Sharemax, who also were directors of all the other Sharemax companies involved in the prospectus had had no intention to comply with Notice 459. (Refer in this regard to section 2 (b) of the attached summary of the Notice.)

26. Section 4.3 makes provision for the disbursement of investors' funds to pay for the entire shareholding in The Villa Retail Shopping Investments (Pty) Ltd (The Villa (Pty) Ltd) from Sharemax. There is no detail as to how this benefited investors. In the same section 4.3, the prospectus discloses that investor funds will be paid out to the seller of the immovable property via a sister company, namely, The Villa (Pty) Ltd and later to Capicol 1, long before the transfer of the immovable property into the name of the syndication vehicle.

27. The movement of the funds was illegal and a direct affront to the very legislation that was meant to protect investors (refer to section 2 (b) of the Notice). I conclude that respondent must have been oblivious to the risk and could not have appropriately advised complainant in that case.

Conflict of interest

28. The prospectus does not hide the universal role of the promoter, highlighting that investors would have no protection whatsoever as the directors would only be accountable to themselves. The investors were therefore at the mercy of the directors. Respondent seems to have overlooked this fact.

29. I refer also to the conflicting provisions of the prospectus (see paragraphs 19.10 and 4.3). First, paragraph 19.10 states that funds collected from investors would remain in the trust account and investors would be paid their return from the interest accumulated therefrom. Paragraph 4.3 on the other hand conveys that the funds would not remain in the trust account long enough since 10% would be released after the cooling off period of seven days to pay commissions. The aforesaid is

confirmed in the forms that complainant had completed to make the investment. This payment too, was in violation of the Notice.

30. Two problems arise with the proposition that the investor's return was paid from the interest generated by the trust account:

30.1 Interest payable by the bank on investments made in line with section 78 (2A) at the time did not go beyond one digit. In fact, this office obtained information that the interest payable at the time was between 6.4% - 8.25%[7]. Sharemax promised between 11% and 11.5 %.

30.2 The prospectus is unequivocal that the funds would not stay in the trust account long enough to have accumulated any significant interest since it was withdrawn, firstly after seven days to fund commissions and subsequently thereafter, to fund the acquisition of the immovable property.

31. The prospectus issued by The Villa refers to a Sale of Business Agreement (SBA), concluded between The Villa (Pty) Ltd and the developer Capicol 1 (Annexure A3). Two types of payments are dealt with in the SBA. These are payments to the developer, and agent Brandberg Konsultante (Pty) Ltd. (Brandberg).

Payments to Capicol

32. According to the agreement, investors' funds were moved from The Villa Ltd to The Villa (Pty) Ltd and advanced to the developer of the shopping mall. At the time of releasing the prospectus of The Villa, Sharemax had already advanced substantial amounts to the developer in line with this agreement[8]. A brief analysis of the business agreement reveals:

32.1 No security existed for the loan and this is clear from reading the prospectus and the agreement.

---

[7] http://www.fidfund.co.za/banking-options/credit-interest-rate-history/ accessed on 20 July 2017.

[8] Paragraph 4.23 of The Villa prospectus

32.2 The prospectus states that the asset was acquired as a going concern, but the building was still in its early stages of development.

32.3 At the time the funds were advanced to the developer, the immovable property was still registered in the name of the developer. Although the prospectus mentioned the intention to register a mortgage loan, there is no evidence that this was done.

32.4 The developer paid interest of 14%, from which Sharemax took 2% and paid the remaining 12% to the investors of The Villa.

32.5 The agreement is devoid of detail relating to the assessment of the developer's credit worthiness.

32.6 No detail is provided to demonstrate that the directors of The Villa had any concerns about the Notice 459 violations.

32.7 There are no details regarding the economic activity that generated the 14% return paid by the developer.

32.8 The only rational conclusion is that the interest paid to investors came from their own capital.

33. There was no evidence that the developer had independent funds from which it was paying interest. Besides, if the developer had the financial standing to borrow such large sums of money at 14% per annum, it would have gone to mainstream commercial sources.

Payments to Brandberg

34. An entity known as Brandberg was paid commission in advance. The commission is said to have been calculated at 3% of the purchase price of R2 900 000 000, according to the SBA. There are no details of how these payments benefited investors. No valid business case is made as to why commission had to be advanced, in light of the risk to investors. There was also no security provided against this advance to protect the investors' interests.

G. FINDINGS

35. On the basis of the reasoning set out in this recommendation, the risks in the investment were not disclosed, 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'"*

36. Respondent further violated the Code in terms of section 8 (1) (a) to (c) and section 2. The investment represented a significant portion of the complainant's accumulated savings. Furthermore, the late Mr O'Grady was a 74 year old pensioner who had sustained substantial losses, and could ill afford any further loss of capital. Whilst complainant may have required a higher income and appreciated that he may have to accept a little more risk than his conservative risk profile suggested, the recommendation to place complainant in an investment as risky as that of Sharemax was blatantly inappropriate.

37. Respondent, as mentioned above, failed to provide complainant with a recommendation that was appropriate to his needs and circumstances and, despite the fact that complainant had sought a higher income, there is no indication that respondent had adhered to the provisions of section 8 (4) of the Code.

38. The representations made to complainant were incorrect and in violation of section 3 (1) (a) (vii) of the Code. There is no doubt that had the complainant been made aware of the risks involved in these investments, they would not have invested in any of the schemes.

H. CAUSATION

39. The question that must be answered is whether respondent's flawed advice caused complainant's loss. Had respondent complied with the Code and sought investments that were in line with complainant's circumstances, there would have been no investments in Sharemax. Respondent must have known that his client was going to rely on his recommendation in making the investment. It

stands to reason that the respondent caused the complainant's loss, which loss must be seen as the type that naturally flows[9] from the respondents' breach of contract.

I. RECOMMENDATION

40. The FAIS Ombud recommends that respondent pay complainant's loss in the amount of R500 000.

41. The respondents are invited to revert to this Office within TEN (10) working days with their response to this recommendation. Failure to respond with cogent reasons will result in the recommendation becoming a final determination in terms of Section 28 (1) of the FAIS Act[10].

42. Interest at the rate of 10.25 % shall be calculated from a date TEN (10) days from date of this recommendation.

Yours sincerely

_____

Marc Alves

Team Resolution Manager

---

9 *Administrator, Natal v Edouard* 1990 (3)SA 581 (A); *Thoroughbred Breeders' Association of SA v Price Waterhouse* [2001] 4 All SA 161 (A), 2001 (4) SA 551 (SCA), paragraphs 46-49; Compare in this regard, *First National Bank v Duvenhage* [2006] SCA 47 (RSA).

10 "*The Ombud must in any case where a matter has not been settled or a recommendation referred to in section 27(5)(c) has not been accepted by all parties concerned, make a final determination, which may include-*
(a) the dismissal of the complaint; or
(b) the upholding of the complaint, wholly or partially…."