momentum
investments

moment
OF TRUTH

Legal update 2 of 2020: Case law on financial advisory and intermediary services

Introduction

There have been several recent cases relating to the Financial Advisory and Intermediary Services Act 37 of 2002 (Fais Act). Below are summaries of these cases and insight into what a financial services provider (FSP) should do should they come across similar instances. We have also included more detail on the cases in the document.

Summaries

Case 1: Collins and others vs Accredinet Financial Solutions (Pty) Ltd and another Fais 08548/10-11; 08546/10-11 GP (Fais Ombud) – failure to understand and explain risk of investment.

- The finding: Sections 8(1)(a) and (b) of the General Code of Conduct of the Fais Act provide that all relevant and available information must be considered in determining the appropriateness of an investment.
- What the FSP should do: When giving financial advice as per the Fais Act, the FSP should offer the client advice based on an individual risk assessment and the client's needs. The client should be informed of all the required information and potential risk of any investment recommended by an FSP.

Case 2: Pieter Cronjé Makelaars vs Van Zyl & others Case No. FAB 19/2019 August 2019 (FST) – voluntary acceptance of risk by investor.

- The finding: The Financial Services Tribunal held that where an investor had elected to receive information about an investment in a property syndication scheme that was less than the information envisaged in section 8(4) of the General Code of Conduct, and the investment failed, the FSP was not liable for the loss suffered by the investor. The investor has voluntarily accepted the risk of investing in the scheme
- What the FSP should do: An FSP should always provide at least the minimum information that is envisaged in section 8(4) of the FAIS General Code of Conduct.

Case 3: Craig Wright Financial Planners CC and another FAIS 07240/11-12 KZN (FAIS Ombud) – failure to disclose investment risk

- The finding: The fact that a client approached an FSP with a request to receive more information regarding a potential investment in a high-risk property syndication scheme will not absolve the FSP where an investment is made and capital is lost. This happens if due diligence by the FSP in complying with the requirements laid down, in sections 8(1)(a) - (c) of the General Code of Conduct was not done.
- What the FSP should do: When giving financial advice under the FAIS Act, the FSP must ensure that the client is aware of the potential risk of the investment chosen. The FSP should also provide the client with all the

required information and inform them of the potential risk of the recommended investment.

Case 4: Pienaar vs Introvest 2000 CC and another FAIS 03052/12-13 LP (FAIS Ombud) – conflict of interest, liability for loss.

- **The finding:** The FSP was personally liable for damage suffered by an investor where the provider failed to disclose a conflict between his own interest and that of an investor.
- **What the FSP should do:** When giving financial advice as per the Fais Act, the FSP should provide investment advice that is factually correct, adequate and appropriate in the circumstances to all its clients.

More detail of the cases

Case 1: Collins and others vs Accredinet Financial Solutions (Pty) Ltd and another Fais 08548/10-11; 08546/10-11 GP (Fais Ombud) – failure to understand and explain risk of investment.

The complainants, now deceased, on the advice of the second respondent, the FSP, invested R780 000 in The Villa Retail Park (The Villa), a property syndication scheme promoted by Sharemax. The investments failed and the capital was lost.

At the time the advice was provided, the complainants were retired. The complainants lodged a complaint with the Fais Ombud to recover their investments. After the death of the complainants, the first respondent (Collins, in his capacity as executor of the estates of the complainants) (the executor) requested the Fais Ombud to continue with its investigation into this matter.

The FSP, in its response to the complaint, argued that the complainants at all times understood the nature of the investment and the associated risks and that the FSP cannot be held liable for the complainants' loss.

The complainants were pensioners and the money used for investment were from existing investments, which did not perform as the complainants expected. At the time of investing in The Villa, the complainants were 71 and 68 years old respectively.

Further, at the time when the advice was given to them, the complainants requested the preservation of their capital. The FSP failed to provide any evidence that he had determined whether the investments in The Villa, were appropriate for the needs and circumstances of the complainants.

Sections 8(1)(a) and (b) of the General Code of Conduct provide that all relevant and available information must be considered in determining the appropriateness of an investment. The FSP further failed to provide proof that he had discharged his statutory duty to inform the complainants of the inherent risks in the investment in The Villa and the failure contravenes sections 3(1)(a)(i) and 7 of the General Code.

The complaints were upheld and the FSP was ordered to pay the executor of the complainants' estates an amount of R780 000 plus interest.

Case 2: Pieter Cronjé Makelaars vs Van Zyl and others Case No. FAB 19/2019 August 2019 (FST) – voluntary acceptance of risk by investor.

The first two respondents (the investors) invested money in a Sanlam Glacier product. Eventually, they were no longer satisfied with the returns from the Sanlam investment and approached the FSP to discuss the investment. The FSP advised the investors to invest in two Sharemax property syndication schemes.

The investors attended presentations and meetings about Sharemax, following which they made several investments in the scheme during more than two years. The investment collapsed and the investors' capital was lost.

The investors complained to the Fais Ombud. The Ombud determined that the FSP was negligent in recommending

the investment and ordered the latter to refund the lost capital. The FSP then applied for reconsideration of the matter in terms of section 230 of the Financial Sector Regulation Act (FSR Act) to the Financial Services Tribunal (FST).

The FSP listed several grounds on which the Fais Ombud allegedly erred in determining the matter, including that the Ombud adopted a blanket approach to determine complaints dealing with property syndication schemes, as opposed to investigating each matter.

The crux of the appeal made by the FSP was whether the FSP had provided "inappropriate advice" as stated in the Ombud's determination. The following considerations were taken into account during the appeal of the Fais Ombud determination.

The liability of an FSP is usually based on a breach of contract. The contract between the FSP and the investor requires the former to advise with an appropriate degree of skill and care; that is, not negligently.

The test for negligence is based upon the factual matrix of the dispute in question. Investments carry risks, however, some investments carry a greater degree of risk than others. Therefore, it is the duty of the FSP to disclose the reasonably foreseeable risks of the particular investment to the client.

In the present case, the investors put their signatures next to each insertion or cancellation in the mandate between them and the FSP, including the clause that refers to investment capital being guaranteed after the investment term.

The FST concluded that it was likely that the investors substantially understood the nature of the investment and were well aware of the risks involved. This is because the investors attended presentations and meetings relating to the investment in question. They further acknowledged having been provided with relevant documentation and prospectuses on each investment.

The FSP performed several due diligence tasks, including contacting and obtaining responses from attorneys and auditors, who worked on the Sharemax investment documents. This conduct is in line with the provisions contained in section 8(4) of the General Code of Conduct.

In conclusion, the FST found that the need of the investors to receive a higher rate of return was met, as they repeatedly invested more in the scheme to get better returns.

The determination of the Ombud was accordingly set aside and remitted to the Ombud for reconsideration in terms of section 234(1)(a) of the FSR Act.

Case 3: Craig Wright Financial Planners CC and another Fais 07240/11-12 KZN (Fais Ombud) – failure to disclose investment risk.

The complainant approached the FSP, Craig Wright, who had been his FSP since 2006, to enquire about an investment in a property syndication scheme. The FSP proceeded to provide the complainant with more information on the main features of the product.

In a subsequent meeting between the complainant and the FSP, the FSP allegedly assured the complainant that the product could not fail because it offered secure growth and capital preservation. The FSP also provided the complainant with a prospectus of one of the syndication schemes.

The complainant invested R560 000 in various property syndication schemes. The investments failed and the complainant's capital was lost. The complainant lodged a complaint with the Fais Ombud.

The complainant believed that the FSP did not recommend an investment product that was appropriate for his known conservative risk profile. Although the FSP conducted a needs analysis, the FSP could not explain how he relied on this information when he recommended the investment to the complainant.

The failure is a clear breach of the FSP's duties in terms of sections 8(1)(c) of the General Code of Conduct. The FSP complied with his duties in terms of sections 8(1)(a) and (b) of the Code of Conduct. However, the FSP failed to consider whether the investment was, in fact, suitable to the complainant as required under section 8(1)(c).

The FSP accepted that because the complainant had enquired about the product in question, it was enough for him to then recommend that particular product to the complainant and not any other.

The complaint was upheld and the FSP was ordered to pay the complainant an amount of R560 000 plus interest.

Case 4: Pienaar vs Introvest 2000 CC and another Fais 03052/12-13 LP (Fais Ombud) – conflict of interest, liability for loss

The complaint arose out of a failed investment of R700 000 in a scam known as BondCare.

BondCare solicited investments from investors. The second respondent (Mogentale) controlled it. The scam operated as follows: "Investors were told that their monies were paid into an attorney's trust account and would be advanced to conveyancing attorneys to provide bridging finance. However, the investments were never so deposited and Morgentale and his accomplice paid themselves undisclosed amounts from the investments."

In November 2009, the Registrar of Banks appointed an investigator to establish whether BondCare or any of its associated entities were conducting the business of a bank. Following the investigation, BondCare, in 2010, introduced a new funding model. Two new entities were registered, including BondCare CC.

BondCare CC was marketed as a low-risk investment and claimed to be a licensed FSP. However, BondCare CC was never licensed In terms of the FAIS Act. Mogentale illegally allowed BondCare CC to use BondCare's licence.

The complainant was one of many investors who lost their investment in BondCare. After that, he lodged a complaint with the Fais Ombud. The latter's office investigated the complaint, also requesting Mogentale to respond to the allegations against him. Mogentale failed to respond to the complaint.

Mogentale was aware of the lack of governance within the BondCare entity and that no measures existed to protect investors from the embezzlement of their money by the trustees, who were meant to safeguard the interests of investors.

Section 3 of the Code of Conduct provides that investment advice to investors must be factually correct, adequate and appropriate in the circumstances. The complainant was led to believe that she was making a legitimate investment into a sound financial institution.

Section 3(1)(b) also provides that the FSP must avoid or mitigate any conflict of interest between the provider and the client. 'Conflict of interest' includes a financial or ownership interest, as was the case with Mogentale and BondCare. Mogentale failed to disclose his financial interest in BondCare to the complainant. Further, the risk inherent in BondCare was not suitable for the complainant's circumstances.

The complaint was upheld and the respondents were ordered to pay the complainant R700 000 with interest.

Hettie Joubert
Head: Wealth and Retirement Fund Legal