INVESTMENT BROKERS' LIABILITY: HOW GREAT IS THE RISK?

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For many years, South African law on the negligence of investment advisers or brokers was governed by *Durr v Absa Bank Ltd and Another* [1997] 3 All SA 1 (A) and *Cooper and Others v Syfrets Trust Ltd* 2001 (1) SA 122 (SCA). The legislature has since sought to prescribe the proper conduct of financial services providers (FSPs), a group which includes investment brokers.

Broadly, FSPs are regulated by the Financial Advisory and Intermediary Services Act (37 of 2002) (FAIS) and by the General Code of Conduct for Authorised Financial Services Providers and Representatives (Published as Board Notice 80 of 2000) developed pursuant to FAIS.

There have been a number of recent decisions which set out the manner in which the negligence of an investment broker is to be determined, with reference to these legislative instruments.

This issue received much attention in the wake of *Oosthuizen v Castro* 2018 (2) SA 529 (FB), in which the Bloemfontein High Court held an investment broker liable for negligence after he advised a widow to invest in the Sharemax scheme. Daffue J indicated that the obligations outlined in statute are **in addition** to the level of care espoused in previous cases.

Judge Daffue found the investment broker's conduct lacking in that he failed to consult with independent attorneys or accountants in order to properly understand the financial structure, and was consequently unable to understand that the investment was unlikely to generate income. Moreover, he recommended an investment in the scheme despite a number of reputable publications which warned of the pitfalls in the investment. The evidence of the expert witness supported the view that the scheme was not viable.

An important factor in this case was the profile of the investor and the risk tolerance communicated to the investment broker. The investor was a widow who wanted a safe investment and could not afford to lose "two cents". The Sharemax investment was patently high risk, and unsuitable for her needs. Daffue J took a dim view of the investment broker's conduct, particularly when viewed against the value of the commission which he had raised, and concluded that he was negligent.

In March 2019, the Supreme Court of Appeal (SCA) in *Centriq Insurance Company Limited v Oosthuizen and Another* 2019 (3) SA 387 (SCA) remarked that the high court's findings in relation to this issue were "unassailable".

In December 2018, in *Symons N.O. and Another v Rob Roy Investments CC t/a Assetsure* 2019 (4) SA 112 (KZP) the Durban High Court per Ploos van Amstel J also considered an investment into the "Sharemax scheme". He stated, at the outset, that the investment was high risk, but the degree of risk was not necessarily indicative of an irresponsible investment. On the contrary, whether the advice regarding an investment is irresponsible is to be determined with reference to the particular investor, the objectives of the investment, and the context and background of the investment itself.

Both the Plaintiffs and the Defendants called expert witnesses who testified on their views on the viability of the scheme itself and the advisability of investing.

Of particular importance in this case was the profile of the investor: he was an "astute businessman who managed his own share portfolio" and had previously invested in similar investments. He was given a prospectus of in-

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formation and, according to Judge van Amstel, made the investment "with his eyes open" and after sufficient time to consider it. In addition, the investment adviser had attended seminars and training regarding the investment and was properly apprised of its workings.

Judge van Amstel pointed out that the failure of an investment should be causally linked to the alleged breach by the broker to attract liability. That is to say: in this particular case, the loss suffered by the investor did not seem to be linked sufficiently closely or directly to any failure on the part of the investment broker to explain the risks of the investment. The only evidence before the court regarding the failure of the scheme pointed to the intervention of the Reserve Bank. It was not alleged that this was reasonably foreseeable by the broker.

He considered the applicability of the findings in *Oosthuizen v Castro*. Aside from the variance in risk profile between the respective investors, an important distinguishing feature between that case and the current one was the evidence led by the parties. Although both cases concerned an investment in the same scheme, the evidence before the court was not to the effect that the investment was unsustainable. He therefore concluded that neither negligence nor causation had been established.

In March 2019, in *Atwealth (Pty) Ltd and Others v Kernick and Others* [2019] 2 All SA 629 (SCA), the SCA dealt with similar issues regarding investment products offered by a "hedge fund management company".

The SCA highlighted that a breach of statutory obligations does not necessarily amount to liability in delict as the common law Aquilian action requirements must be fulfilled. In order to consider whether this was so *in casu*, the SCA indicated that it was crucial that evidence was led regarding the manner in which the product was initially advertised to the investors. Such evidence was not before the SCA.

In addition, no evidence was led regarding "what a reasonably skilled financial service provider would know about products in the marketplace; what due diligence they would have done before making a presentation to a prospective client and what sources of information they would have consulted".

In summary, no evidence was before the SCA to demonstrate what advice would have been furnished by a reasonable financial adviser at the time to these investors regarding these products. Furthermore, there was no evidence to explain how the products commenced and operated or why they went insolvent.

The SCA concluded that there was insufficient evidence before it to support the investors' claims. They had thus failed to discharge the onus of proving negligence on the part of the investment broker and their appeal was dismissed.

An assessment of these cases suggests to us the following cumulative criteria required to pursue a claim against an investment broker in terms of FAIS and the common law:

1. A breach of FAIS and the Code;
2. A breach of a common law legal duty owed to prospective investors;
3. Conduct giving rise to a factual link between the breach and the loss suffered (the *conditio sine qua non* test); and
4. Conduct sufficiently closely or directly linked to the loss to give rise to legal liability (establishing legal causation)

A breach of FAIS of its own accord is insufficient to determine civil liability of an investment broker and the criteria listed demonstrate that a breach of FAIS and/or the Code does not amount to a breach of a legal duty on its own for purposes of delictual liability.

The law since *Durr* and *Cooper* has largely remained the same: liability is still determined with reference to what a reasonable investment broker would do in the position of a defendant. The introduction of FAIS regulates the conduct and responsibilities of the FSPs to their clients, but a breach thereof is not automatically indicative of negligence on the part of a FSP.

Cumulatively, these cases are a reminder to legal practitioners of the importance of correctly investigating and pleading a client's claim and the evidence to be led at trial. Moreover, they give useful guidance about the manner in which the delictual requirements interact with the statutory requirements, and the manner in which the conduct of an investment broker is assessed. ●

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