

What constitutes financial advice?

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21 May 2019

What conduct constitutes financial advice and what would amount to negligent financial advice?



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In *Atwealth (Pty) Ltd & Others v Kernick & Others* (28 March 2019) the Supreme Court of Appeal (SCA) was called upon to decide, among other issues, these questions.

While the legislature has provided a definition of what advice is, it is not always determinable whether conduct of a financial advisor constitutes financial advice.

In this matter, the claimants approached Moolman in her capacity as a financial advisor for advice on how best to invest their "spare money". Moolman compiled a presentation with a specific focus on two products and following the presentation, the claimants made investments of approximately R8m accordingly. The claimants contended that they were assured by Moolman that the two companies recommended by her to invest in generated higher returns through legitimate investment vehicles, however, this was not the case. As a result, the claimants suffered substantial financial loss.

Moolman and her erstwhile employers were sued on the basis that Moolman failed to comply with her legal or statutory duties, which she owed to them, and had given negligent advice that caused them financial loss.

The court correctly remarked the basis of the claimants' claim against Moolman was premised in delict as opposed to a breach of statutory duties.

Financial advice or not?

The first issue the SCA grappled with was whether Moolman's conduct amounted to financial advice as envisaged by legislation.

In *Gumede v JDG Trading (Pty) Ltd (Trading as Barnett's)* the Fais Ombudsman remarked that in interpreting the Financial Advisory and Intermediary Services Act, 2002 (FAIS), it must always be borne in mind that the purpose of Fais is to regulate the rendering of certain financial advice and intermediary services to clients.

The ombudsman further emphasised that the definition of advice is set out in plain and unambiguous language therefore one must first consider the plain language of Fais.

In section 1 of Fais, "advice" means "any recommendation, guidance or proposal of a financial nature furnished by any means or medium to a client in respect of purchasing any financial product, or in respect of the investment in any financial product or on the conclusion of any other transaction including a loan or cession aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product or 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 investment in any such product and irrespective of whether or not such advice is furnished in the course of or incidental to financial planning in connection with the affairs of the client or results in any such purchase, investment, transaction variation, replacement or termination, as the case may be, being affected".

Advice in terms of Fais is rendered by a financial services provider who is defined as "any person who as a regular feature of the business of such person furnishes advice, or furnishes advice and any intermediary service, or renders intermediary service".

Similarly, the Financial Sector Regulation Act, 2017 defines "financial service" to include among others, providing advice, recommendations or guidance in relation to a financial product, a foreign financial product, a financial instrument or a foreign financial instrument.

Section 1(3)(a) of Fais limits the ambit of "advice" and sets out what is not considered advice. It provides that advice does not include factual advice given merely on the procedure for entering into a transaction in respect of any financial product, in relation to the description of a financial product, in answer to routine administrative queries, in the form of objective information about a particular financial product or by the display or distribution of promotional material. Further, "advice", does not include an analysis or report on a financial product without any express or implied recommendation, guidance or proposal that any particular transaction in respect of the product is appropriate to the particular investment objectives, financial situation or particular needs of a client.

Moolman contended that she had merely given the claimants objective information about particular financial products and at best, so the argument went, Moolman's conduct was nothing more than advice on the procedures for concluding an investment transaction.

The court found that the presentation by Moolman to the claimants constituted financial advice. The court's finding was on the basis that the presentation was in fact advice that the claimants clearly intended to rely on and which they had a right to rely on, as it was advice coming from a professional financial advisor.

The court further found that the presentation and the documents used in the proposal by Moolman constituted guidance in respect of the purchasing of specific financial products. This went beyond merely describing the financial investments and the mechanisms that the claimants could invest. In the court's view, the information was provided to induce investment, so that Moolman could receive a commission.

The characteristics of financial advice that are outlined in this case include guidance that is intended to induce investment, and which is intended to be relied on by the client.

Negligent financial advice?

The second issue to be decided by the SCA was whether the financial advice was negligent under the circumstances and required examination of Moolman's statutory duties.

The General Code of Conduct for Authorised Financial Services Providers and Representatives in section 2 requires a financial services provider at all times to 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. Section 3 of the code places specific standards that must be met when a financial services provider renders a financial service.

The court remarked that even if the information used by Moolman in her presentation to the claimants was incorrect, it does not automatically mean that she was negligent, unless it can be shown to the court that she ought to have been aware of the irregularities in the information. The onus is on the claimants to show that a reasonable financial advisor in the position of Moolman would have given warnings to the claimants about the shortcomings of the investment that would have caused them not to make the investment.

The question of what a reasonable financial advisor would have done requires that the standard test for negligence be considered, which was set out in *Mukheiber v Raath & Another*. The test is simply whether a reasonable person in the position of Moolman would have foreseen harm of the general kind that actually occurred, would have foreseen the general kind of sequence by which that harm occurred, would have taken steps to guard against it, and Moolman failed to take those steps.

When deciding what the standard of a reasonable financial advisor is, the court in *Durr v ABSA Bank Ltd* is instructive in this regard. In *Durr*, the court held that making that decision will have regard to the general level of skill and diligence possessed and exercised by members of the profession to which the member belongs. The court further held in *Durr* that when the court decides on what is considered reasonable, it will consider what skills that particular financial services provider should display and what skills the financial services provider held out to possess. It was held in *Durr* that lack of skill or knowledge on the part of a financial services provider does not necessarily amount to negligence, what would be considered negligent, however, would be if the financial services provider voluntarily engaged in any potential dangerous activity without having the necessary skill and knowledge for that activity.

In the circumstances, the court found against the claimants as they evidently failed to prove negligence against Moolman based on the presentation or lack thereof, of evidence to impute negligence.

It is important to emphasise that when examining whether the conduct of a financial services provider constitutes financial advice, regard must be given to the definition of advice according to Fais and the code. The inquiry is a factual one and will always be determined by the facts of each matter. The SCA has provided useful guidelines in determining the test in this regard. However, to hold the financial advisor liable for financial loss of any kind, negligence needs to be proved regardless of the apparent breach of statutory duties.

ABOUT THE AUTHOR

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