IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NO: FAIS 03921/13-14/ NC1

In the matter between:

ANDRIES PETRUS BRITZ	**First Complainant**
MARIA CHRISTINA BRITZ	**Second Complainant**

and

JOHAN MARAIS FINANCIAL SERVICES CC	**First Respondent**
JOHAN MARAIS	**Second Respondent**

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

A. PARTIES

[1] First complainant is Andries Petrus Britz, an adult male pensioner whose details are on file in this Office.

[2] Second complainant is Maria Christina Britz, an adult female pensioner whose details are on file in this Office.

[3] First Respondent is Johan Marais Financial Services CC, a close corporation with registration number 2004/118666/23, duly incorporated in terms of South African law, with its registered place of business at 35 Stals Street, Meiring Park, Worcester, 7849.

[4] Second Respondent is Johan Marais, an adult male key individual and representative of first respondent. The regulator's records note second respondent's address as the same as that of first respondent's. First respondent was authorised as a financial services provider on 8 February 2006, with license number 21024. The license is still valid.

[5] At all material times hereto, complainant dealt with second respondent in purchasing this investment.

[6] I refer to first and second respondents collectively as respondent, and to first and second complainants, as complainant. Where appropriate, I specify which complainant or respondent.

B. BACKGROUND TO REALCOR

[7] Purple Rain Properties 15 (Pty) Ltd (herein referred to as Realcor) was an authorised financial services provider registered with the Financial Services Board under license number 31351. Realcor used various subsidiary companies for the purpose of obtaining funding from the public for its development projects. The subsidiaries included Grey Haven Riches 9 Ltd, Grey Haven Riches 11 Ltd and Iprobrite Ltd (hereinafter, collectively referred to as "Realcor"). Midnight Storm Investments 386 Limited[1] ("MSI"), also part of the Realcor group, owned the immovable property on which the hotel known as the Blaauwberg hotel (or simply the hotel) was being constructed.

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[1] Registration number 2007/01927/06

[8] The businesses of most of the companies within the Realcor group was conducted under the directorship of Ms Deonette De Ridder, (De Ridder) and Mr WB Nortje, (Wimpie Nortje). De Ridder however, appeared to have been the driving force behind the three subsidiaries mentioned in paragraph [7] of this determination.

[9] The Realcor subsidiaries raised money by issuing the investing public with one (1) year and five (5) year debentures and various classes of shares. In that way, the group[2] was able to raise amounts in excess of R600 million from the public; monies which were said to have been earmarked for the construction of the hotel.

[10] The debentures and shares were marketed as attractive on the basis that investors would receive monthly interest payments and dividends both before and after the construction of the hotel. The target market was mostly elderly persons who were mainly concerned with making provision for post-retirement income.

[11] Whilst an ordinary bank savings account would accumulate a single digit interest per annum at the time, Realcor investors were promised more than 10% interest per annum. In the absence of legitimate economic activity that would generate cash inflows, it was not clear how this return was to be achieved.

[12] Notwithstanding the above, Realcor investments were marketed as safe and guaranteed, with minimal risk of loss of capital as the investment was in "property" such as the hotel.

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[2] The Realcor group

[13] On 21 April 2008, the South African Reserve Bank (SARB) appointed PricewaterhouseCoopers ("PwC"), initially as inspectors in terms of section 11 of the South African Reserve Bank Act[3] to conduct an inspection into the affairs of the Realcor Group, and subsequently as managers in terms of section 84[4] of the Banks Act[5].

[14] Having considered the report of the inspectors, (PwC), the Registrar of SARB (Registrar) concluded that the activities of Realcor, in raising funds from the public, was in conflict with the Bank Act. Realcor was ordered to return funds collected from investors. Consequently, the developer was unable to complete the construction of the hotel with the construction activities having come to a rapid halt[6].

[15] The hotel was subsequently sold for approximately R50 million; the majority of which is likely to have been paid to FNB as one of the secured creditors, thereby reducing the chances of a dividend to unsecured investors.

[16] Iprobite was liquidated on 25 October 2011 following the granting of a voluntary order by the High Court.

[17] In light of the liquidation, many of Realcor's investors approached this Office for assistance in order to claim their investment capital from the brokers who intermediated the investments.

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3 Act 90 of 1989

4 *"Simultaneously with the issuing of a direction under section 83(1), or as soon thereafter as may be practicable, the Registrar shall by letter of appointment signed by him or her appoint a person (hereinafter in this section referred to as the manager) to manage and control the repayment of money in compliance with the direction by the person subject thereto."*

5 94 of 1990

6 *Southern Palace Investments 265 Ltd v Midnight Storm Investments 386 Ltd & O*, Western Cape HC, Case No: 15155/2011, paragraph 13

[18] In the meantime it has transpired that some brokers who sold the Realcor investments have tried to avoid their responsibilities (towards their clients) under the FAIS Act by contending, *inter alia*, that the Reserve Bank's intervention in Realcor was the cause of the Realcor collapse. Using this reasoning, the brokers applied to Court for an order indemnifying them from their clients' claims. They (brokers) asked the Court for an order to hold PwC liable for the investors' losses, on the basis that the investments were sold to the public whilst PwC were managers and in charge of Realcor. In pursuing the relief sought, the brokers argued that the report of the inspectors (PwC) had neither been placed before a competent court, nor published, and that Realcor itself had never had the opportunity to interrogate the report.

[19] The Western Cape High Court[7] (the court) rejected the brokers' case and confirmed that PwC only supervised Realcor and did not take control of its daily operations; such control remained in the hands of Realcor's directors until it was liquidated[8]. The Court further held that PwC were bound by confidentiality provisions and could not have disclosed the report to the brokers, Realcor, nor the investing public. The brokers' application was dismissed with costs.

[20] The judgement of the Western Cape High Court supports the intention of the legislature that providers of financial services cannot avoid their clients' losses

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7 Judgement delivered on 7 October 2014: *Willem Van Zyl & Deon Pienaar v PricewaterhouseCoopers & Others* HC WC Case No.: 12511/2013. Mr Van Zyl and Pienaar were amongst the brokers who had sold the Realcor product to members of the public. Their application came in the wake of investors who sued Realcor brokers for losses of their investments after its collapse. They unsuccessfully argued that they should be indemnified from these claims as Realcor collapsed while in the hands of PwC and not in Realcor directors' hands.

8 It appears that PWC's mandate continued until Realcor was liquidated when the liquidators took control thereof.

where such arises out of the provider's failure to comply with the FAIS Act and its subordinate legislation.

[21] Before going any further, it is important to first highlight the multiple roles played by Realcor within the Realcor group of companies:

21. 1 As mentioned in paragraph [7] (of this determination), Purple Rain Properties 15 (Pty) Ltd traded as Realcor.

21.2 Realcor was the Promoter of the property syndication investment, the property developer and authorised agent of MSI (the owner of the land on which the hotel is constructed).

21.3 Realcor is also the collective name used to refer to the subsidiary companies that were used to raise funds from the public, namely, Grey Haven Riches 9 Ltd, Grey Haven Riches Ltd 11, and Iprobite Ltd.

21.4 Realcor further played the role of manager of investor funds.

C. COMPLAINT

[22] From the papers provided to this Office, it would appear that with both investments respondent only communicated or rather rendered the financial service to first complainant, Mr Britz. There are two investments in dispute, one in the name of first complainant, and the other in the name of second complainant, Mrs Britz.

[23] During February 2009 first complainant met with respondent, seeking investment advice. Respondent advised him to invest in Realcor, as "*they provided 20% interest*". On 24 February 2009, first complainant signed an

agreement to invest R460 000 in Grey Haven Riches 9 Ltd[9] and on 8 May 2009, second complainant signed an agreement to invest R60 000, also in Grey Haven Riches 9 Ltd. Both investments were made for a period of twelve (12) months.

[24] At the time of making the investments first complainant had already retired and the investment funds originated from his pension proceeds, which were initially invested with Absa Bank.

[25] Upon maturity of the two investments (between February and May 2010), complainant again visited respondent's offices for advice in respect of investment opportunities. Respondent advised complainant to re-invest the funds[10] in Realcor. According to complainant's version, it appears that respondent had already drawn up the re-investment forms and all complainant needed to do was to append signatures.

[26] The funds were subsequently re-invested in Realcor upon advice of respondent. On 11 February 2010, an amount of R552 000 was invested in Grey Haven Riches 11 Limited[11] in the name of first complainant and on 4 May 2010, an amount of R72 000 was invested in Iprobrite Limited[12], in the name of second complainant.

[27] According to complainant, respondent had at no point in time drawn his attention to the risks associated with these investments. Respondent only informed

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9 A public company with registration number 2007/022968/06

10 Which included the original capital and proceeds

11 A public company with registration number 2007/025464/06. The offer was promoted by Purple Rain Properties 15 (Pty) Ltd t/a Realcor Cape with registration number 1997/004873/07.

12 a public company with registration number 2009/007170/06

complainant that the re-investment was for a period of 5 years and that this was due to some problems that Realcor picked up with the Reserve Bank.

[28] After the proceeds of the initial investment became available (between February and May 2010) and these proceeds were re-invested, first complainant became uneasy about the re-investment. He contacted respondent, informed him that he was not "comfortable with the re-investment" and wanted to withdraw. Respondent assured him that the investment was safe and he had nothing to worry about. As a result of respondent's assurances, complainant's concerns were assuaged.

D. RELIEF SOUGHT

[29] Complainants individually seek repayment of their invested capital which, when combined, results in an invested amount of R592 000.

[30] The basis of the claim against respondent is the latter's failure to render financial services in line with the FAIS Act and the General Code of Conduct (the Code) which includes respondent's failure to appropriately advise complainant and disclose the risk involved in property syndication investments.

E. RESPONDENT'S RESPONSE

[31] Complaint was first directed to respondent, in terms of Rule 6 (b) of the Rules on Proceedings of this Office, on 3 September 2013. In his response to the complaints, respondent merely attached the investment application forms, proof of payment into Realcor's account and various other documents. He did not seek to defend the appropriateness of his advice, nor did he contest the allegations made against him.

[32] On 11 June 2015, a notice in terms of section 27 (4) (the notice) was sent to respondent. The notice invited respondent to provide this Office with his case, including supporting documents. The notice further informed that he is viewed as a respondent and could be held liable in the event the complaint is upheld.

[33] In responding to the notice, respondent quoted sections of the General Code of Conduct for Authorised Financial Services Providers and Representatives (the Code) setting out what he, as an advisor, ought to have done when rendering the services to complainant; however he did not show how he upheld the Code as per the quoted sections.

[34] When responding to the question seeking the information respondent relied on in deciding that the investments were appropriate for his clients, he simply stated:

"*Risk profile is a debatable subject and since the beginning until today there [are] still different methods and ways to try determine a client's risk profile*".

[35] Respondent also added:

"Realcor Cape was not regarded as a property syndication. Clients [were] invited to become shareholders in a 5 star hotel which was contracted to be managed by the Raddison Hotel Group……The Value of the property was disclosed by independent property valuers. This was not seen as a high risk investment, to invest with African [Bank] was a more risky investment, fortunately government bailed them out". Respondent's statement in this regard suggests that respondent was not aware that Realcor was a property syndication investment offering. Logically, he would not have been able to

explain the investments accurately to his clients as he himself did not know what they were.

F. DETERMINATION

Justiciability of the complaint

[36] In terms of Rule 4 (a) a complaint is justiciable if four conditions are met, namely

(i) the complaint falls within the ambit of the FAIS Act and the Rules;

(ii) the person against whom the complaint lies is subject to the provisions of the FAIS Act;

(iii) the conduct complained of occurred at a time when the Rules were in force; and

(iv) the person against whom the complaint lies has failed to address the complaint satisfactorily within six weeks

[37] The person against whom the complaint lies had, according to this Office, failed to address the complaint satisfactorily. With the requirements of Rule 4 (a) having been met, the complaint became justiciable.

Whether the jurisdictional requirements set out in section 27 (4) of the FAIS Act were fulfilled by this Office

[38] Respondent, through the section 27 (4) notice, was informed of the complaint and afforded sufficient time to put his case before this Office. Respondent was further warned, *inter alia*, that:

(i) this Office considers him as a respondent;

(ii) in the event the complaint was upheld, he could be held liable; and

(iii) upon receipt of his version, the Office would determine the complaint without further reference to him.

Accordingly, the jurisdictional grounds set out in section 27 (4) of the FAIS Act have been met.

[39] Issues for determination:

39.1 Whether respondent, in advising complainant, violated the FAIS Act and the Code in any way. The real issue is whether complainant was appropriately advised prior to concluding the investments.

39.2 If it is found that respondent's conduct violated the Act and the Code, whether such conduct caused the losses now complained of; and

39.3 Quantum.

Whether complainants were appropriately advised as required by the Code

Infractions of Notice 459

[40] In considering this question, it is necessary to consider whether respondent's advice took into account the laws surrounding this investment. In this regard, I refer to respondent's reply to this Office. It is apparent from his reply that respondent did not know that complainants' capital was invested in property syndication. Had respondent taken time to acquaint himself with the type of investment he would have realised that it was nothing less than a property syndication. In the circumstances, the disclosure documents used to invite the public to invest had to comply with relevant laws and regulations.

[41] On 30 March 2006 the Minister of Trade and Industry, acting in terms of section 12 (6) of the Business Practices Act (Act 71 of 2008) published Notice 459 of 2006 (the Notice) in Government Gazette No 28690, in which two 'business

practices' were declared unlawful with effect from 30 March 2006. Persons were directed to (a) refrain from applying the unfair business practices and (b) refrain at any time from applying the unfair business practices.

[42] The Notice declared unlawful any business practice whereby the prescribed information, in part or otherwise, as stipulated in annexure "A" (of the Notice) is withheld by promoters or their representatives from investors or potential investors in public property syndication schemes.

[43] A 'public property syndication scheme' is defined in the Notice as:

'the assembly of a group of investors invited, by word of mouth or through the use of electronic and print media, inter alia, radio, television, telephone, newspaper and magazine advertising, brochures and direct mail, to participate in such schemes by investing in entities, which could be companies, close corporations, trusts, partnerships or individuals, whose sole asset(s) are commercial, retail, industrial or residential properties, and where investors share in the profits and losses in these properties and or enjoy the benefits of net rental growth therefrom through proportionate share of income';

[44] A 'promoter' includes a company and its directors and all other persons who were actively involved in the forming and establishment of a public property syndication scheme.

[45] The Notice directs that promoters must make available in a disclosure document the prescribed information to investors who invest in, or intend to invest in, public property syndication schemes. The Notice also provides that any person who does not comply with the requirements of the Notice commits

a criminal offence, and would be liable on conviction to a fine not exceeding R200 000 or to imprisonment for a period not exceeding five years, or to both that fine and imprisonment.

[46] In terms of section 1 (b) of the Notice, investors shall be informed in writing that:

(i) public property syndication is a long-term investment, usually not less than five years;

(ii) there is a substantial risk, in that the investor may not be able to sell his shares should he wish to do so in the future;

(iii) it is not the function of the promoter to find a buyer should the investor wish to sell his shares; and

that it is the investor's responsibility to find his own buyer."

[47] The prospectuses issued by the Realcor subsidiaries did not publicly use the words public property syndication (property syndication) nor did the prospectuses show full compliance with the Notice. For example, there are several references to risk to the investors in some pages of the prospectuses. It therefore cannot be said that the full warning as contemplated in section 1 (b) was communicated to the investors.

[48] In terms of section 2 (a), investors ought to have to have paid their funds into a registered trust account of an attorney or chartered accountant with the name of the trust account appropriately spelt out. Section 2 (b) stipulates that investor funds could only be withdrawn in the event of registration of transfer of the immovable property into the name of the syndication vehicle or underwriting, with the details of the underwriter properly disclosed, or repayment to an investor in the event of the syndication not proceeding. Contrary to the

provisions of section 2 (b), investor funds were paid into Realcor's account and thereafter disbursed as intercompany loans to sister companies, prior to registration of transfer. Refer to Eloff J's remarks in *Southern Palace Investments 265 Ltd v Midnight Storm Investments 386 Ltd* wherein he said :

"Of importance is the fact that Purple Rain apparently acted as the banker in the Realcor group. Various funds were channelled through Purple Rain between the companies in the Realcor group. Ultimately, Purple Rain's accounting records were said to reflect positive balances in respect of various intercompany loans that were relied upon in its own business rescue application, as constituting its major asset. However, such assets were plainly valueless because the intercompany loans were irrecoverable. A proper set of financial statements for Purple Rain would have probably reflected a complete impairment of such suggested assets".

[49] Despite being presented with numerous opportunities to show that he had exercised due diligence, respondent presented no evidence to this effect.

[50] Had respondent conducted due diligence as demanded by section 2 of the Code, he would have learnt of the 2008 inspection by SARB, and ought to have realised then that Realcor was not a proper investment and directed his clients elsewhere with their money.

[51] The information available to this Office was insufficient to justify a competent financial advisor to conclude that Realcor was a sound investment, much less an investment suitable for retirees.

[52] The prospectus itself conveyed the message that Realcor had no interest in conducting its business in line with sound corporate governance practices. I say so for the following reasons: First, Iprobrite (as well as Grey Haven 9 and 11) were managed by the promoter, (Realcor) which was also the property developer. The directors of Realcor (the promoter) were essentially the same as those of the property developer together with its subsidiaries. It is also apparent from respondent's response that he had no idea what amount was claimed by each of these companies for the services rendered to the other. For example, respondent had no idea how much Realcor, the promoter, claimed for managing investor funds from the subsidiary companies. A basic knowledge of corporate governance[13] would have alerted respondent to the inherent risk to investors arising from the glaring conflict of interest.

[53] Secondly, contrary to respondent's assertions, investor's funds were also not "safe" as the directors of both Iprobrite and the property holding company had unlimited borrowing powers.[14]

[54] Most importantly there is no evidence that there was ever an independent board of directors within the entire Realcor group. Thus, it would appear that the directors were accountable to themselves. In fact, one of the directors even involved her family trust in the Realcor business[15].

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13 Reference is drawn to the King II report where one of the seven characteristics of good corporate governance is independence. It is explained as: "*Independence is the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareowner. These mechanisms range from the composition of the board, to appointments to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences*".

14 Paragraph 9.10 page 25 of the prospectus

15 Paragraph 9.12 page 25 of the prospectus.

[55] The directors of the companies decided their own remuneration. Without the existence of an oversight body, they were free to spend investors' funds as the pleased.

[56] For more information about the Iprobite prospectus, refer to the determination of *Faro v Groenland Insurance Brokers CC*[16].

[57] In light of the above I can only conclude that respondent failed to appropriately advise complainants and apprise them of the risks involved in Realcor, in violation of section 7 (1) of the Code. 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.

[58] It follows that complainants could not have made an informed decision about the Realcor investments.

[59] With evidence that respondent was neither aware that the investment was a property syndication nor the risks involved, it follows that respondent could not have complied with section 8 (1) (a) to (c) of the Code.

[60] Respondent further failed to act in his clients' interests in violation of section 2 of the Code.

G. CAUSATION

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16 FAIS-00947-11/12 UN 1

[61] Complainants invested in Realcor as a result of respondent's advice. This means that had it not been for respondent's advice, complainants would not have made investments in Realcor and would not have suffered the loss of their capital. This answers the test for factual causation.

[62] The next step is to establish whether, as a matter of public and legal policy, it is reasonable to impose legal responsibility on respondent for the failure of the investment. In other words, could respondent have reasonably foreseen the collapse of Realcor.

[63] The reasonable foreseeability test did not require that the precise nature or the exact extent of the loss suffered or the precise manner of the harm occurring should have been reasonably foreseeable for liability to result; it was sufficient if the general nature of the harm suffered by complainant and the general manner of the harm occurring was reasonably foreseeable.

[64] I refer in this regard to *Standard Chartered Bank of Canada v Nedperm Bank Ltd*[17] wherein the Court held that:

"as to the issues of loss and causation, that although the untrue report issued by the respondent had been a factual cause of the appellant's loss, the test to be applied to the question whether the furnishing of the untrue report had been linked sufficiently closely or directly to the loss for legal liability to ensue was a flexible one in which factors such as reasonable foreseeability, directness, the absence or presence of a novus actus interveniens, legal policy, reasonability, fairness and justice all played a part."

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17 1994 (4) SA 747 (AD)

[65] Had respondent followed the law by considering complainants' circumstances and conducting due diligence on the entities he recommended, he would have understood that the investments were unsafe and posed risks complainants had no capacity to absorb. Respondent, for example, would have known about the SARB inspection of 2008 and its directive that Realcor return the monies that were unlawfully collected from investors. Respondent would have also been aware that the prospectus issued by the subsidiary companies were not compliant with Notice 459.

[66] Respondent's inappropriate advice caused complainants the loss complained of.

H. FINDINGS

[67] I make the following findings:

67.1 Respondent failed to conduct due diligence in direct contravention of section 2 of the Code.

67.2 Due to the fact that respondent failed to conduct due diligence, he had no appreciation of the risks involved in the Realcor offer and could therefore not have been in a position to advise complainants on the suitability of the investments.

67.3 Respondent failed to acquaint himself with the regulations pertaining to property syndication environments. He could not see that the prospectus issued by Realcor violated Notice 459.

67.4 Respondent's conduct caused complainants' loss.

I. QUANTUM

[68] Complainants invested R624 000.

[69] Accordingly, an order will be made that respondent pay the amount of R624 000 plus interest.

J. ORDER

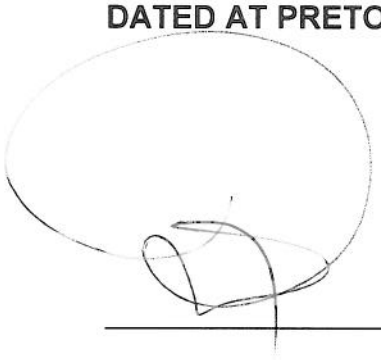
[70] In the premises, the following order is made:

1. The complaint is upheld.

2. Respondents are ordered to pay to the first complainant, jointly and severally, the one paying the other to be absolved, the amount of R552 000 and to second complainant, R72 000.

3. Interest shall be calculated at rate of 10, 25% from a date seven (7) days from date of this order to date of final payment.

DATED AT PRETORIA ON THE 24th DAY OF APRIL 2017



NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS