FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS-05279-10/11 GP 1

20 March 2018

MR HJ VAN REENEN

Per email: vanreenen.hennie@gmail.com; ulana@vhkp.co.za

Dear Sir

NELIA BARNARD (complainant) v **HENDRIK JOHANNES VAN REENEN** (respondent)

RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT (37 of 2002)

A. INTRODUCTION

1. During August 2010, the complainant filed a complaint with this Office against the respondent. The complaint arose from a failed investment made by the complainant during September 2007, on advice of the respondent.

2. The complainant's funds were invested in a company known as Spitskop Village Properties Limited[1] (Spitskop) which purchased[2] a portion of land in the Steelpoort area in Mpumalanga with the aim of rezoning the land to build approximately 2500 residential properties. The scheme itself was promoted by Bluezone Property Investments (Pty) Ltd[3] (Bluezone), a Financial Services Provider (FSP).

3. The complainant at the time was stationed in Japan as a diplomat. During a holiday to South Africa, she met with the respondent to invest an amount of R200 000 which she had accumulated in savings. Based on the assurance provided by the respondent that an investment in Bluezone would be guaranteed and provide good returns with no risks, the complainant proceeded with the investment.

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[1] Registration number 2006/011790/06

[2] The property was purchased from Blue Dot Properties (Pty) Ltd, a subsidiary of Bluezone. The directors of Blue Dot were the same as that of Spitskop

[3] Registration number 2005/00831/07

4. The complainant received monthly interest on her investment until approximately July or August 2009. The complainant subsequently became aware of Bluezone's troubles after she was alerted to various news articles by her mother in South Africa. Shortly thereafter, in August of 2009, Spitskop Village Properties were liquidated.

5. The complainant would like her capital to be refunded, especially since she trusted the respondent's advice that the investment was sound.

B. THE PARTIES

6. The first complainant is Nelia Barnard, an adult female whose particulars are on file with the Office.

7. The respondent is Hendrik Johannes van Reenen, an adult male whose last known address according to the Regulator's records are 1215 Cornelia Street, Suiderberg, 0082. The respondent was an authorised financial services provider with license number 26030 which lapsed on 13 December 2010. At all material times, the respondent rendered financial services to the complainant.

8. The respondent marketed the Bluezone investment as a representative of Bluezone, in terms of Section 13 of the FAIS Act. The respondent submitted documentation confirming his appointment on 24 July 2007 as a representative of Bluezone.

Delays in finalising this complaint

9. Given our mandate to resolve complaints expeditiously, it is important that I deal with the delay in finalising this complaint. Sometime in September 2011, after the Office issued the *Barnes* determination[4], the respondent in that matter brought an urgent application to set it aside[5]. Before the fate of the application could be known, the respondents sought an undertaking from this Office that it would not proceed to determine any other property syndication related complaints involving them.

10. Since no legal basis existed for the respondent's demands, the Office proceeded to determine further property related complaints, to which the respondents replied with an urgent application for an

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

[5] The respondent claimed that section 27 of the FAIS Act was unconstitutional

interdict to stop the Office from filing the determinations in court and issuing further determinations against them. The decision in the original application, favouring the FAIS Ombud, was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[6].

11. The Office continued to determine complaints involving property syndications after the High Court decision[7]. However, in 2013 following the *Siegrist* and *Bekker* determinations[8] 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 was a precautionary and necessary risk-management step, as the Office had for the first time sought to hold the directors of property syndication schemes liable for complainants' losses. The said appeal was finally decided in April 2015[9], after which the Office resumed processing complaints involving property syndications, with due regard to the *Siegrist and Bekker* decision. As many as 2000 complaints had to be shelved pending the Appeals Board decision.

C. THE COMPLAINT

12. The complainant indicated that the respondent had been her financial service provider for a number of years. He knew that she was a conservative investor, and she therefore trusted that his advice would be appropriate to her circumstances.

13. The aim of the investment was to earn better interest on the R200 000 that she saved, through a solid investment. The complainant stated that she was hesitant about the Bluezone investment, however, the respondent told her that it was a "sure deal" that even his own family invested in. He informed her that it was a platinum development which was guaranteed in every way.

14. Realising that there was a problem after seeing the media reports and being contacted by the police in respect of a criminal investigation into the activities of the syndication, the complainant contacted the respondent about her investment. Despite the state of affairs, he assured her that she would recover at least 80-90% of her investment.

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6 Gauteng High Court Division, case number 50027/2014

7 Referred to in paragraph 6 of this recommendation

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

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

15. When the complainant attempted to complain to the respondent about the loss of her capital, he ignored her, conduct she considered negligent. She feels that she was a victim of investment fraud, and would like her capital to be refunded.

D. RESPONDENT'S VERSION

16. In compliance with Rule 6 (b) of the Rules on Proceedings of the Office of the Ombud, the Office referred the complaint to the respondent during November 2010, advising him to resolve the complaint with his client. The respondent's replies are summarised below:

16.1 The respondent confirmed that he had a longstanding relationship as financial advisor to the complainant. During 2007, the complainant indicated that she wanted to buy additional property. The respondent then suggested the Spitskop development as an alternative. It was a 3 year investment with expected returns higher than inflation. The investment would further mature in line with the end of her contract in Japan.

16.2 The complainant already had a linked investment with Momentum, as well as retirement savings, and an investment in residential property. Since she allegedly wanted an investment that would outperform inflation, interest-bearing alternatives were not an option as they would create a tax liability. The Spitskop investment was therefore a good alternative to diversify her portfolio.

16.3 The respondent further stated that it was evident from the disclosure document, marketing brochure, application form and background homework done by the client herself that she was well informed when she took the decision to invest in Spitskop.

16.4 The respondent conducted a risk profile analysis, confirming the complainant to be a moderately aggressive investor. In addition, the complainant was presented with an indemnity contract[10] that she had to sign, thereby acknowledging that she could not hold the respondent liable for any loss that she might suffer as a result of breach of contract.

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[10] The indemnity contract was an attempt by the respondent to contract out of any liability arising from the breach of contract of obligations between the syndication and the investors.

16.5 The respondent denied advising the complainant that the capital would be guaranteed. Other than a guarantee of monthly payments, no other guarantees were implied.

16.6 The respondent claimed that he could not have known that it would be risky doing business with Bluezone, especially in light of the fact that they were licensed by the FSB. When the problems about Bluezone emerged, he informed his clients about what he knew at the time. He could not assist in disinvesting the complainant's investment, as the debenture was only redeemable at the end of the 3 year term.

16.7 The respondent stated that he attempted to resolve the matter with the complainant, to no avail. The complainant implied that he misled her into investing into a fraudulent transaction which, the respondent stated, was never his intention.

17. On 17 June 2016, a notice in terms of Section 27 (4) of the FAIS Act was issued, informing the respondent that the complaint had not been resolved and that the Office had intention to investigate the matter. The respondent was invited to provide the Office with his case, together with supporting documents, in order for the Office to begin its investigation. The letter invited the respondent to deal with the question of appropriateness of advice, taking into account the risk involved in the investment and complainants' circumstances.

18. The respondent submitted a voluminous file of papers previously received, via his attorneys, on 27 July 2016. The respondent did not deal with the questions raised in the notice, nor his failure to comply with the Code.

E. INVESTIGATION

19. The respondent was provided with a further opportunity during March 2017 to address the Office in terms of section 27 (4) of the FAIS Act. Some of the questions raised (omitting words not essential) are set out below:

- *Property syndications are high risk investments for a number of reasons, let alone the fact that they are structured as unlisted companies. The basis upon which the properties are valued are never fully disclosed. Did you ever confirm the valuation figures shown in the prospectus with the cited property valuer?*

- *Being unlisted means that such an investment should be considered as a capital risk investment. Investors such as the complainant are at risk, as unlisted shares and debentures are not readily marketable and the value is also not readily ascertainable. Should the company fail, which ultimately occurred, this may result in the loss of the investor's entire investment. Did you explain this to your client?*

- *The prospectus of [Bluezone] makes it plain that [Bluezone] was the promoter, the company secretary, property manager and manager of investor funds. Given the overwhelming conflict of interests, what steps did you take to ensure that your client will not be short-changed by the directors of the syndication?*

- *The prospectus further informs potential investors that there is essentially no independent board of directors..........Given that there was no independent board of directors (as provided for in King III) what steps did you take to satisfy yourself that your clients will be protected against director misconduct?*

- *Given the absence of an independent board, how were you going to ensure that investor funds are used for what they were meant for and within proper governance prescripts?*

- *You should be aware that the oversight of a board includes the appointment of an audit committee whose function, amongst others, is to receive assurance from an independent audit firm. An audit committee's oversight also includes satisfying itself that there are proper controls within the entity, and that the information contained in the financial statements of the entity can be relied on. Given there was no audit committee and no audited financial statements, what information did you take into account to conclude that this was a viable investment?*

- *You may be aware that Government Notice 459 of Gazette 28690 mandates that investor funds must be kept in a trust account until registration of transfer into the name of the syndication vehicle, or upon agreement with an underwriter, whose name must be made public. Given that the prospectus makes it clear that investors' monies will be advanced to a developer, what made you recommend the product to your client, in the face of this high risk?*

- *What steps did you take after noting that the promoter has an interest in the syndication? We require proof of the actions taken to ensure that your client was provided with this material information in order to make an informed decision?*

- *We would like you to spell out the steps you took to understand the risk involved in this product, including how you appraised your client of these risks............We are also looking for a record of advice, which must have been provided to your client at the time of rendering the service.*

- *What information did you rely on to conclude that this investment is 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. We need a record that shows that you elicited personal information from your client, including his financial circumstances, to demonstrate that you understood his circumstances prior to advising them.*

20. The respondent replied on 28 March 2017. However, instead of dealing with the questions raised, the respondent indicated that the content of the letter was misdirected, in that the "requests" as per the letter did not seem to form part of the responsibilities of the financial broker, but that of the Financial Services Board (FSB). To this extent, the respondent referred a similar notice to the FSB for its response.

21. Despite a reminder on 15 November 2017 to respond to the aforesaid letter, no further communication was received.

F. ANALYSIS

22. It is clear from the available information that the parties had an agreement that the respondent would render financial services to the complainant. The specific form of financial service that this complaint is concerned with is advice. This advice had to meet the standard prescribed in the FAIS Act and the General Code of Conduct, such that any material breach of the Act and Code would amount to a breach of respondent's contractual duties.

The law

23. 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.

24. Section 7 (1) 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'.*

25. 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..."

26. Lastly, section 9 provides for the keeping of a record of advice which <u>must</u> reflect the following:

(a) a brief summary of the information and material on which the advice was based;

(b) the financial product [sic] which were considered;

(c) the financial product or products recommended with an explanation of why the product or products selected, is or are likely to satisfy the client's identified needs and objectives; and

(d) where the financial product or products recommended is a replacement product as contemplated in section 8(1)(d) –

(aa) the comparison of fees, charges, special terms and conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided, between the terminated product and the replacement product; and

(bb) *the reasons why the replacement product was considered to be more suitable to the client's needs than retaining or modifying the terminated product...*

G. CONSIDERATION OF THE MATTER

Disclosure document

27. Having considered the attached summaries of Bluezone's disclosure document, as well as the violations of Notice 459, I conclude that the respondent had no legal basis to recommend this investment to his client. The advice was in violation of Section 8 (1) (c) of the Code. My reasoning is set out below:

27.1 There is no evidence that an independent board of directors existed within the Bluezone group of companies. Paragraph 12.2 of the disclosure document provides that the directors of the Company are also directors of Bluezone, and Mr Lamprecht and Mr van Zyl are also directors of the seller of the immovable property and facilitator. Mr Lamprecht's name also appears as a director of the developer of the property.

27.2 Bearing in mind that there was no independent oversight body in the form of a board and investors were not represented at any decision making structure, it is fair to conclude that investors would have no protection and were at the mercy of directors right from the start. That investors would have no protection is confirmed by the statement in the disclosure document that the directors will have borrowing powers limited to 10% of the directors' bona fide valuation of the net asset value of the Company, from time to time.

27.3 As is evident from the summary, Bluezone was the principal, the marketer, and property manager. Coupled with the aforesaid, there are number of intricate contracts; for example a promoter agreement and a facilitator agreement. All of these allowed the contracting parties to claim fees. A basic knowledge of corporate governance[11] would have alerted the respondent to the inherent risks of this glaring conflict of interest.

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[11] 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".*

27.4 No audited financial statements of any of the schemes that were promoted by Bluezone existed, including this particular scheme. Given the absence of an independent board, the respondent had no indication as to how investors would be protected by ensuring that the funds would be used for what they were meant for, and within proper governance prescripts.

27.5 It is stated in paragraph 6 of the disclosure document that the Company would use investors' funds to purchase and develop the immovable property, pay offer costs (which includes the promoter's costs), as well as partially service the interest on debentures. It was clear from the onset that investors would be paying their own interest.

27.6 Paragraph 3.8 of the document provides that all funds received from investors will be deposited in a trust account managed and held by the attorneys until such time as the relevant units are allocated and issued. Paragraph 10.14 draws investors' attention to the fact that on payment of the subscription amount for the units to the attorneys, and acceptance by the Company of the relevant application, an amount equal to 10% of the invested amount will be released to the promoter to be utilised for payment of commissions. Investors' funds were never safe, in contravention of the provisions of Notice 459.

27.7 The promoter (Bluezone) was paid a substantial amount of investors' funds. The amount payable to the promoter was R23 317 500[12]. It was also noted that the promoter shall be entitled to an additional fee as provided for in the promoter agreement. This amount as per paragraph 10.15 amounts to 30% of the amount exceeding the projected profit.

27.8 None of the companies mentioned in the documents had any trading history, which does not appear to have been explained to the complainant in terms of the risk she was facing. There is no indication that the complainant was informed that she would receive shares linked to a debenture, which was linked to a loan account and subject to penalties upon premature sale.

27.9 I conclude that the respondent did not appreciate the risk involved in this investment and in that case, could not have appropriately advised his client.

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12 See paragraph 9 of the disclosure document

Risk analysis

28. The risk analysis, completed by the respondent for the complainant, incorrectly stated that she was a moderately aggressive investor. The score she received places her as a moderate investor, which is defined as *"long term investors who want reasonable but relatively stable growth. Some fluctuations are tolerable, but investors want less risk than that attributable to a fully equity based investment"*.

29. The analysis confirms that the complaint sought a consistent investment that would produce growth over time. The respondent stated in his reply that he never guaranteed the investment, only the monthly returns. Considering the remarks under paragraph 4 of the disclosure document, it is questionable how the respondent concluded that the investment would be appropriate for the complainant, or if any of these risks factors were explained to the complainant:

    29.1 The higher returns associated with real estate are due to the inherent risks in the investment itself.

    29.2 There is a risk that the Company may default on its obligations or produce insufficient profits to make any payments of returns or capital due to investors. The respondent therefore should not have advised the complainant that her monthly returns would be guaranteed.

    29.3 It is stated that security would be required for investors' investments, although investors' security will rank behind the securities of, for example, banks. It was already demonstrated that the directors had the power to borrow from the Company and apply for a mortgage loan, thereby risking the safety of investors' money.

    29.4 An investment in unlisted units or shares is not a liquid investment as there is no established market for the sale of the units.

30. I conclude that the respondent had no appreciation for the risk inherent in the company he was inviting his client to invest in.

Record of advice

31. The respondent has failed to produce a record of advice as provided for in section 9 of the Code. This Office is entitled to draw an adverse inference against an FSP who fails to keep such a record, even

though the failure to keep a record of advice, on its own, will not necessarily be a cause of loss of an investment and, consequently, grounds to hold the FSP liable for the loss[13].

32. However, in the absence of a proper record of advice, it is not clear what made the respondent conclude that the complainant's needs could only be addressed by means of a property syndication product. There is no evidence that the respondent considered other types of investments with less risk than property syndications.

33. The respondent's conduct, as evidenced above, was an attempt to disregard the Code. Section 8 (1) states that a provider **must,** prior to providing advice, take reasonable steps to seek appropriate and available information from the client, conduct an analysis and identify suitable products. It was the respondent's duty to determine the suitability of the investment, and not that of the complainant. The respondent had no basis to transfer that duty to the complainant.

34. There is no indication that the respondent considered other alternatives that would have been more suitable to the complainant. In this regard, the respondent has violated section 8 (1) (a) – (c) of the Code.

Indemnity contract

35. The respondent has placed reliance on an indemnity contract he had the complainant sign upon concluding the Spitskop investment, thereby relinquishing himself from any liability.

36. It is stated in the agreement that the respondent is not involved in any capacity with the syndication company other as an accredited distribution channel mechanism between the company and the investor. It is further noted in the agreement that the respondent cannot be held responsible for any breach of contract of obligations between the property syndication promoters and the investor.

37. What the respondent failed to understand, is that he cannot contract outside the parameters of the FAIS Act and the Code of Conduct, not even under the auspice of acting as a section 13 representative of Bluezone. The complainant did not find herself in this predicament of having lost her investment because of the failure of the syndication, but because of the inappropriate advice the respondent

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13 See in this regard ACS Financial Management and Others v Coetzee, FAB 1/2016, paragraphs 55 – 56

gave her with regards to the investment. The mere conclusion of such a contract amounts to negligence.

Due diligence

38. The respondent, in advising the complainant, relied on the disclosure document and advertising material provided by Bluezone. Even though the violations of law were evident from the disclosure document at the outset, the respondent ought to have sought independent advice on the new product he wanted to sell to his clients. I refer in this regard to the matter of *Audenberg Versekerings Makelaars CC and Others v Waterboer*[14], where the Appeals Board recently pronounced as follows:

*"...... In the recent judgment of **Oosthuizen v Castro (2858/2012) [2017] ZAFSHC 163; [2017] 4 All SA 876 (FB)** the court quoted with approval the following from **Durr v Absa Bank Ltd and Another (424/96) [1997] ZASCA 44; [1997] 3 All SA 1 (A)**:*

Either he had to forewarn the [clients] where his skills ended, so as to enable them to appreciate the dangers of accepting his advice without more ado, or he should not have recommended [the investment]. What he was not entitled to do was to venture into a field in which he professed skills which he did not have and to give them assurances about the soundness of the investments which he was not properly qualified to give...."

39. I conclude that the respondent failed to disclose the risk involved in the investments, violating 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."*

40. The complainant was entitled to accept that the respondent, in rendering financial services to her, would act according to the standards contemplated in section 8 of the Code as reinforced by section 2, which, based on all the violations cited in this recommendation, was not the case.

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

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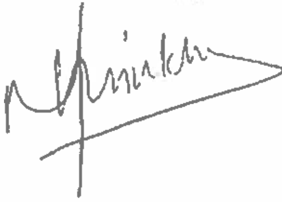
[14] FAB 13/2017, paragraphs 21 - 24

H. RECOMMENDATION

42. The FAIS Ombud recommends that the respondent pay the complainant's loss of R200 000.

43. The respondent is invited to revert to this Office within TEN (10) days with his response to this recommendation. Failure to respond will result in the recommendation becoming a final determination in terms of Section 28 (1) of the FAIS Act.

Yours sincerely



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ADV M WINKLER

ASSISTANT OMBUD