IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case number: FAIS 05497/11-12/ NC 1

In the matter between:

ELSA JOHANNA ZANDBERG **Complainant**

and

OPTIMUM CONSULTANTS (Pty) Ltd **First Respondent**

JANNIE R VAN DER MERWE **Second Respondent**

DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT NO 37 OF 2002 (the Act)

A. INTRODUCTION

[1] On 23 November 2011, complainant filed a complaint with the Office against first and second respondent.

[2] The complaint relates to financial services rendered in respect of an investment in the Highveld 19 property syndication, which was promoted by PIC Syndications (Pty) Ltd. Details of the complaint and the response are set out here below.

B. THE PARTIES

[3] Complainant is Elsa Johanna Zandberg, an adult female whose details are on file at this Office.

[4] First respondent is Optimum Consultants (Pty) Ltd, registration number 1998/020208/07, a duly registered company in terms of the laws of South Africa, with its principal place of business recorded as Optimum Building, 54 Schroder Street, Upington.

[5] First respondent is a licensed financial services provider as provided for in terms of the FAIS Act, with license number 9413. The license was issued on 12 October 2004 and is still in force.

[6] Second respondent is Jannie R van der Merwe, key individual and representative of the first respondent, through which he conducts his business. Second respondent's address is Optimum Building, 54 Schroder Street, Upington.

[7] I refer to first and second respondents as respondent. Where appropriate, I specify.

C. BACKGROUND

[8] Before addressing the facts of this complaint, I consider it appropriate to set out the background to the Highveld Syndication Companies (HS). HS consisted of a number of syndication companies, namely, (15 to 18 and 19 to 22). For the purposes of this determination, I will refer to the HS 19 only[1].

[1] Refer to the matter of *Oberholster and Others v Zephan Properties (Pty) Ltd* Case No 2762/2012 which was heard in the Free State High Court. The Court set out how the companies interlinked.

[9] PIC Syndications (Pty) Ltd, (commonly known as Picvest), then an authorised financial services provider[2] and promoter of the syndications, marketed the shares through a network of brokers.

[10] Picvest allegedly had a well-established network of investment consultants and accredited financial advisers who marketed the shares coupled with loan accounts.

[11] In marketing PIC's offer to the public, investors were told that they had to buy a share coupled with a loan account from a public company, which was part of the group. The public company was meant to purchase immovable property, which was meant to be registered debt free in the name of the public company. Shareholders were meant to then receive the necessary shareholders' certificate as proof of ownership.

[12] Investors were further told that a head lease and buyback agreement with the company Zephan Properties (Pty) Ltd, would ensure a stable monthly income over a specific period and secure capital growth in the property investment, after a fixed investment term.

[13] According to the prospectus, investors' funds were to be held in the trust account of attorneys, Eugene Kruger & Company Inc. until the syndication company took occupation[3] of the properties in question.

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[2] PICVEST Investments (Pty) Ltd with License number 20878, which has since been withdrawn, according to the Registrar of Financial Services.

[3] contrary to Notice 459 of Government Gazette 28690 of 2006, which demands that investors' funds be kept in a trust account until registration of transfer to the syndication company.

[14] It is a matter of fact that Picvest (Pty) Ltd withdrew the funds from the attorneys' trust account, prior to the transfer of the properties, paid the funds to the sellers and without reference to the investors, cancelled the sale agreements between the syndication companies and various sellers, and a company known as Orthotouch Limited, 'Orthotouch', entered into agreement with the sellers and the syndication companies, in terms of which Orthotouch would buy the properties from the syndication companies. The latter companies were later placed under business rescue in terms of the Companies Act 71 of 2008. Thus, none of the properties were ever transferred to the syndication companies, despite payment having been made.

[15] On the 4th of September 2008 the South African Reserve Bank appointed inspectors to investigate the activities of Picvest to establish whether the latter was conducting the business of a bank. This intervention saw a reduction in income provided by some of the syndication companies, leading to the resultant collapse of the schemes.

D. THE COMPLAINT

[16] Sometime during 2006 complainant, assisted by her husband, contacted respondent with a view to invest some funds, which complainant had received from the Department of Education as a retrenchment pay out. After receiving assurances that the capital would be guaranteed and income of 8 % per annum, with an annual escalation, would be payable, complainant made the investment on 23 November 2006. The investment was meant to provide complainant with retirement income, as she had no provision for retirement.

[17] Alongside the HS 19 investment, complainant was advised by respondent to purchase a retirement annuity with a recurring premium from Momentum. The retirement annuity was funded by income received from the syndication investment.

[18] During March 2011 PIC informed all its investors that their income would be reduced by 50% and that the terms of their investments would also be revised. In this regard, complainant's five-year term was to be revised. Investors were meant to be advised at a later stage of the new terms of their investments. Complainant states that she realised at this point that something was wrong.

[19] Upon contacting respondent to enquire about her investment, it is complainant's version that respondent distanced himself from any claims about the capital being guaranteed, and informed complainant what they already knew, that the term of the investment was to be revised and income reduced. To date, there is no evidence that complainant was paid her capital.

E. RELIEF SOUGHT

[20] Complainant wants respondent to refund the invested amount of R100 000, as well as loss of the monthly income. There is no complaint in relation to the Momentum investment.

[21] The basis of complainant's claim against respondent is the latter's failure to render financial services in line with the FAIS Act and the General Code, which essentially relates to respondent's failure to appropriately advise complainant and disclose the risk involved in the HS 19 investment.

F. RESPONDENTS' RESPONSE.

[22] During December 2011, in compliance with Rule 6(b) of the Rules on Proceedings of the Office of the Ombud ("Rules"), the Office referred the complaint to respondent advising him to resolve the complaint with his client.

[23] The matter was not resolved and respondent subsequently filed his response to the complaint on 31 January 2012.

[24] In his letter of response, respondent stated the following:

24.1 He cannot be held liable in his personal capacity for any losses;

24.2 Interest as guaranteed was paid in accordance with the agreement since 2006, and the fact that the position changed in 2011 is not something he could have foreseen;

24.3 He conveyed the reasons for PIC's withdrawal of the head lease agreements and the buy-back agreements. As an intermediary, he claims to have been taken by surprise and had to rely on the directors of PIC for explanations;

24.4 He denied that he informed complainant that there were no capital guarantees. Respondent however, confirmed having advised that Picvest may change the interest rates and the terms of payment. Respondent states that he explained that because of the state of affairs of the syndications, Picvest might pay interest at its discretion and that the terms of the investments were no longer guaranteed.

24.5 He indicated that PIC had since been placed under business rescue, which again guarantees capital, but that the original term of 5 years had been extended by 2 years;

24.6 Respondent concluded that he did not render financial services in a negligent or wilful manner. He also stated that he did not treat any investor unfairly, nor had he transgressed any regulation; and

24.7 Respondent further confirmed having acted as a representative of PIC in rendering financial services to complainant, the allegations should not be against Optimum Consultants.

[25] A notice in terms of section 27(4) of the Act was subsequently sent to respondent on 25 June 2015 inviting respondent to provide this Office with its case including supporting documents in order for the Office to begin its investigation. Respondent was further warned he could be held liable in the event the complaint was upheld. No further response was received from respondent.

G. DETERMINATION

[26] The issues before me are as follows:

26.1 whether respondent, in rendering financial services to complainant, violated the Code and the FAIS Act in any way. In specific terms, the question is whether complainant was appropriately advised, as the Code demands;

26.2 in the event it is found that respondent breached the Code and the FAIS Act, whether such breach caused the loss complained of; and

26.3 quantum.

H. DISCUSSION AND FINDINGS

The prospectus

[27] In order to get a better appreciation of the risks associated with property syndications and the kind of disclosures that should have been made in order to properly advise complainant in terms of the FAIS Act, one has to refer to the statutory disclosures contained in Government Gazette No. 28690, Notice No. 459 of 2006 (notice 459). These are minimum mandatory disclosures to be made by promoters of property syndicates. By extension, any provider who carries property syndications in his portfolio of investment choices, as a form of investment and recommends the investment to clients must be aware of these, and has an obligation to deal with these when advising his or her client. The aim, as set out in the Gazette, is to assist and protect the public when considering these investments.

[28] The Code requires providers to disclose to their client material information to enable consumers to arrive at an informed decision. Section 7 provides as follows:

> *"(1) Subject to the provisions of this Code, a provider other than a direct marketer, must-*
>
> *(a) 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;"*

[29] The material information about this investment is contained in the prospectus and disclosure documents. Before I consider the prospectus and disclosure documents, it is appropriate for me to highlight some relevant provisions of notice 459:

a) Section 1(a) provides that:

"Statements, presentations and descriptions shall not convey false or misleading information about public property syndication schemes and/or omit material information during the public offer of shares. Material information is information which an investor needs in order to make an informed decision."

b) Section 1(b) states that:

"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."

Section 2 (a) requires that investors be informed that funds received from them prior to transfer will be held in an attorney's trust account. But more importantly, section 2 (b) states as follows:

"Funds shall only be withdrawn from the trust account in the event of registration of transfer of the property into the syndication vehicle; or underwriting by a disclosed underwriter with details of the underwriter; or repayment to an investor in the event of the syndication not proceeding."

c) Section 3(c) states that:

"The disclosure document, which is to be dated and signed by the promoter, shall contain a statement of proper due diligence (commercially and legally) with regard to the property and its tenants prior to the unconditional purchase thereof and he/she shall state that this was done and that he/she is satisfied with the results thereof."

[30] Bearing the provisions of notice 459 in mind, I now turn to the prospectus in HS19. I note that the application form indicates that complainant was never provided with the prospectus, but an information brochure. This may suggest that respondent himself did not have sight of the prospectus and could therefore not have advised complainant appropriately. I will nonetheless deal with pertinent aspects of the prospectus.

[31] The following appears from the prospectus:

31.1 In a paragraph titled "Risk Statement" the following appears:

"The registrar of companies does not express a view on the risk for investors or the price of the shares. However, the attention of the public is drawn to the fact that the ***shares on offer are unlisted and should be considered as a risk capital investment****. Investors are therefore at risk as unlisted*

shares are not readily marketable and should the company fail, this may result in the loss of the investment to the investor. The shares are therefore less marketable but the marketing company undertakes to assist shareholders to sell their shares at a market-related commission once this offer has been fully subscribed to".

31.2 There is no evidence that this risk was explained to complainant or that respondent understood the risk. A glance at the record of advice, which will be discussed in more detail later, indicates that the capital was guaranteed. In other words, the advice offered to complainant contradicts the true nature of the investment.

31.3 On page 9 of the prospectus, the following appears:

"*As soon as sufficient funds are received by **"Eugene Kruger & Co Attorneys Trust Account"**, it will be utilised to enable the syndication to **take occupation** of the properties. These funds will be drawn on the instructions of PIC as per agreement between PIC and the investors. The unencumbered properties will be transferred into Highveld Syndication No.19 Ltd."*

31.4 This contravention of section 2 (a) of notice 459 apparently did not raise any red flags on the part of respondent. He also failed to deal with it in his response to this Office. Notice 459 calls for investor funds to be kept in an attorneys' trust account and only allows payment upon **registration of transfer** of the property and not on "occupation". The contract signed by

complainant also states that the promoter may, in its discretion, utilize a portion of the investment for payment of the purchase price or part thereof, as well as related costs, like attorney's fees.

One can only conclude that respondent had no appreciation of the law, the investment and his client's needs. Instead of advising his client that the provisions of the prospectus contravened the law, respondent advised his client that the investment was safe and his capital was guaranteed.

31.5 In as far as the due diligence requirements are concerned, the following is noted on page 18 of the prospectus:

"PIC has completed its due diligence in accordance with the rules as laid out by the Business Practices Committee's Consumer Code on Property Syndication.

PIC is a Company which understands the need of people to earn high returns on their investments. Our mission is to enable investors to earn competitive returns on their investments through property syndications giving its clients a balance income and capital growth.

PIC utilizes uniquely well-situated property syndications as a base for its clients to hedge their investments against inflation.

PIC provides a well-balanced investment vehicle, giving its clients a balance of income and capital. This ensures a steady rental income and capital growth which can be realized at retirement of earlier.

Using a rand cost averaging base, which has a positive historic record, clients enjoy capital appreciation while having a diverse portfolio".

31.6 The requirement laid down in section 3 (c) of Notice 459 has not been met. What is noted in page 18 of the prospectus says nothing about due diligence. It does however, try to market PIC and boost its image, but falls short of the requirements of section 3 (c). Again, respondent failed to note this deficiency and advised complainant that his investment was safe and guaranteed.

31.7 The cancellation clause noted in the contract signed by complainant contradicts what is noted in the prospectus. The prospectus indicates that applications are irrevocable and may not be withdrawn once submitted to the secretary. The contract signed by complainant however, provides for a cancellation period of 3 days. There is no evidence that respondent drew complainant's attention and notice to the contradiction. For a provider to recommend to a client that an investment is suitable when they had not carried out even the most basic of checks, is negligent. Respondent had no business advising clients on this investment.

31.8 On a further reading of the prospectus, it is plain that capital preservation was based solely on the viability of the purchase agreements of the properties and the buy-back agreement. Should any of these contracts fail, the promise made to investors would not materialize. This risk was certainly not explained to complainant, in contravention of section 7 of the Code.

31.9 Although mention is made that a brokerage fee is payable to the promoters in respect of the units, the actual fee is not noted anywhere, nor is there an indication that it was disclosed to complainant. This is a contravention of section 7 (1) (c) (iii).

31.10 Complainant's money was secure in a bank investment, with reasonable interest. Despite the risks noted in the prospectus, respondent nonetheless informed complainant that the HS 19 investment was appropriate to her needs. In other words, complainant was advised that an investment which cannot be guaranteed would be better than a guaranteed investment through the bank.

Record of advice

[32] Section 4 of the record deals with complainant's needs and objectives. Throughout the record of advice, it is indicated that complainant requires a stable investment which would guarantee her capital, and yearly income, in the form of interest payments. The said income would be utilized to fund a retirement annuity.

[33] What follows in section 4 is a comparison of products considered:

i) Bank fixed interest investment – low risk with no growth of interest.

ii) Term annuity – guaranteed capital, fixed interest rate, tax friendly.

iii) Unlisted property with guarantees – high interest rate that grows annually, guaranteed capital.

iv) Unit trust (SA Retail Bonds) – no risk, no commission, fixed interest, capital safe.

The product that was selected by second complainant was HS 19. The reasons were noted as:

"Interest (rental income) starts with 8% and grows yearly. Interest guaranteed through head lease agreement. Full capital (100% allocation) guaranteed and linked to a fixed term through the buy-back agreement".

[34] Had respondent studied the prospectus carefully, he would have realized that none of the aforesaid statements are correct. Even the undated letter from PIC which respondent relied on was a marketing aid, which contradicted the information in the prospectus. It is also unintelligible that respondent, having failed to carry out the most basic checks on the investment, still regarded it as sustainable, in order to fund a committed savings account such as a retirement annuity. As a result, when income from HS 19 ceased, complainant had to rely on her husband to fund the RA. Respondent failed to act in the interest of his client.

[35] By his own admission, respondent concedes that a property syndication would not be suitable for complainant, whom respondent considered as a moderate investor. However, taking into account the guarantee provided by the head lease agreement and the buy-back agreement, he recommended the investment. Had respondent only consulted the prospectus he would have realized that none of what he took into account was real. Respondent's conduct failed to live up to the demands of the General Code, in particular section 2.

Did the respondent appropriately advise the complainant

[36] The complaint centers on the question of appropriateness and suitability of advice by respondent. Complainant relied on, and trusted the advice of respondent. When one considers the prospectus, it is clear that the capital was not guaranteed and was based on the performance of a future buy-back agreement as well as the head lease agreement. In short, this product was not appropriate for complainant's needs. Respondent failed to act in accordance with section 2 of the Code.

I. CAUSATION

[37] Based on complainant's version, the investment in HS 19 was as a result of the respondent's advice. I have already mentioned that based on the violations of Notice 459 alone, respondent should have never recommended the product to anyone. The outcome of the Reserve Bank's enquiry was a further reason for respondent to know that all is not well at PIC. But because of respondent's failure to appropriately advise complainant, an investment was made into HS 19. This answers the factual cause test. The next phase deals with legal causation. The enquiry is whether, as a matter of public and legal policy, it is reasonable, fair and just to impose legal responsibility for the consequences that resulted from the conduct of respondents in giving advice that was inappropriate in terms of the Act and the Code.

[38] Had respondent done his work according to the Act and the Code, no investment would have been made in HS 19, this bearing in mind complainant's circumstances. It is easy and convenient to impute loss to director mismanagement or other commercial causes. Complainant's loss was not caused by management

failure or other commercial influences. The cause of loss was the inappropriate advice to invest in a risky product. That the risk actually materialized, for whatever reason, is not the cause of the loss. Otherwise the whole purpose of the Act and the Code will be defeated. Every FSP can ignore the Act and Code in providing services to their clients and hope that the investment does not fail. Then when the risk materializes and loss occurs they can hide behind unforeseeable conduct on the part of product providers. This will fly in the face of public and legal policy and the provisions of the Act and Code.

[39] 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 that the general nature of the harm suffered by complainant and the general manner of the harm occurring was reasonably foreseeable. A skilled and responsible FSP, acting according to the Act and the Code, would not have advised complainant to invest in HS 19. The loss suffered by complainant is as a result of respondents' inappropriate advice which was reasonably foreseeable by respondent. I refer in this regard to the matter of S*tandard Chartered Bank of Canada v Nedperm Bank Ltd*[4] where 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

[4] 1994 (4) SA 747 (AD)

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."

[40] Information at this Office's disposal points to the following conclusions:

40.1 Respondent had no ability to assess the risk in this investment, yet he advised his client that it was a safe investment and suitable for her risk profile. To even describe the investment as safe and suitable was negligent on the part of respondent.

40.2 Had respondent adhered to the Code, he would have realised that complainant's circumstances were unsuitable for this type of investment.

40.3 Whilst respondent is of the view that he had carried out due diligence, I have already dismissed this as nothing more than smoke and mirrors.

40.4 Respondent cannot deny that at the time he advised complainant, there was no apparent means to protect investors against director misconduct or mismanagement.

40.5 There is equally no evidence that respondent had carried out any work to acquaint himself with the legal environment in which property syndications operate. For this reason alone, respondent may be held liable for causing complainant's loss.

40.6 It was respondent's insistence on selling this investment to complainant, regardless of the surrounding circumstances, that saw respondent violate

his duty to act in the interests of his client and the integrity of the financial services.

[41] I find that, in advising complainant to invest in HS 19, respondent contravened sections 2; 7 (1) and 7 (2); 8 (1) and 8 (2); and 9 of the Code. I also find that this conduct was the cause of complainants' loss.

J. QUANTUM

[42] Complainant invested an amount of R100 000.

[43] Accordingly, an order will be made that respondent pays complainant an amount of R100 000 plus interest.

K. THE ORDER

[44] In the premises, I make the following order:

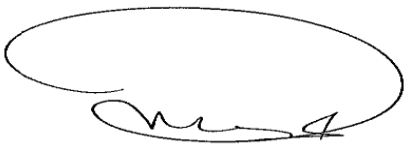
1. The complaint is upheld;

2. Respondents are ordered to pay to complainant, jointly and severally the one paying the other to be absolved, the amount of R100 000.

3. Interest on this amount at the rate of 10.25% from a date 14 days from date hereof to date of payment.

4. Upon receipt of payment, complainant will cede his right to any further claims to respondent.

DATED AT PRETORIA THIS THE 22nd DAY OF NOVEMBER 2016



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