FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS-07397-12/13 GP 1

FAIS-07399-12/13 GP 1

FAIS-07400-12/13 GP 1

28 March 2018

MR HENDRIK VAN SCHALKWYK

HENDRIK VAN SCHALKWYK BROKERS

Per email: Hendrik.vs@mweb.co.za; hendrik@proxima.co.za

Dear Sir

Re: **HELENA PETRONELLA ESPAG** (first complainant) and **MICHELLE PIETERSEN**[1] (second complainant) v **HENDRIK VAN SCHALKWYK MAKELAARS CC** (first respondent) and **HENDRIK VAN SCHALKWYK** (second respondent)

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

A. INTRODUCTION

1. The complainants, following the advice of the second respondent, made various investments in Sharemax[2] and PICvest[3] (two property syndication schemes), during the period of December 2008 – July 2009. The investments totaled an amount of R1 625 000[4].

2. The complainants initially received the monthly promised returns on the Sharemax investments. However, around August 2010 the Sharemax income suddenly stopped. The complainants were informed that the scheme was in trouble and that they might get some of their money back in future,

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1 In her capacity as executrix of the estate late Rudolph Henri Espag in terms of the letter of executorship issued by the Master of the High Court dated 18 February 2015

2 Sharemax Zambezi Retail Park Holdings Limited and Sharemax The Villa Limited

3 Highveld Syndication 21

4 Since each investment constitutes a separate cause of action, the amount falls within the jurisdictional limit of the Office.

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however, no further interest would be paid. To date, the complainants have not received their capital back, despite the investments reaching their terms.

3. In respect of the PIC investments, the complainants were promised a guaranteed monthly income of 12.5% with a full capital return after 5 years. By April 2011, the monthly income reduced by 50%. The capital has not been returned and the complainant continues to receive interest payments through Orthotouch[5], albeit at a fraction of the promised amount.

4. Attempts to resolve the complaints with the respondent were futile. Despite a verbal undertaking to repay approximately R1.5m to the complainants, the respondent failed to comply.

B. THE PARTIES

5. The first complainant is Helena Petronella Espag, an adult female pensioner whose particulars are on file with the Office. The second complainant is Michelle Pietersen, in her capacity as executrix of the estate late Rudolph Henri Espag, in terms of the letter of executorship issued by the Master of the High Court dated 18 February 2015.

6. The first respondent is Hendrik van Schalkwyk Makelaars CC, a close corporation duly incorporated and registered in terms of South African law, with registration number 1993/006496/23. The first respondent's last known address is 880 18th Avenue, Wonderboom South. The first respondent was an authorised financial services provider with licence number 14082. The licence lapsed on 23 August 2017.

7. The second respondent is Hendrik Cornelius Hugo van Schalkwyk, an adult male, key individual and representative of the first respondent at the time. The second respondent's address is the same as that of the first respondent. The regulator has confirmed that Mr van Schalkwyk is currently licensed as an FSP of Discovery Life Ltd.

8. At all materials times the second respondent rendered financial services to the complainant.

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5 Scheme of arrangements sanctioned by the Court in terms of Section 155 of the Companies Act during March 2011

9. I refer to the first and second complainants as "the complainant" and to the first and second respondents as "the respondent". Where appropriate, I specify which complainant or respondent is referred to.

C. DELAYS IN FINALISING COMPLAINTS OF THIS NATURE

10. In view of our mandate to resolve complaints expeditiously, amongst other demands posed by section 20 of the FAIS Act, it is important to address the delay in finalising the property syndication complaints involved in this matter. Sometime during September 2011 (after the Office issued the *Barnes* determination[6]), the respondent in that matter brought an urgent application to set aside the determination[7]. 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.

11. Since no legal basis existed for the respondent's demands, the Office continued to determine further property-related complaints, to which the respondents reacted with an urgent application for an 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 Office, was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[8].

12. The Office continued to determine complaints involving property syndications after the High Court decision. However, in 2013, following the *Siegrist* and *Bekker* determinations[9] 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[10], after which the Office

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

7 The respondent claimed that section 27 of the FAIS Act was unconstitutional

8 Gauteng High Court Division, case number 50027/2014

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

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

resumed the processing of complaints that involved property syndications with due regard to the decision. A substantial number of complaints had to be shelved pending the Appeals Board decision.

D. THE COMPLAINT

13. The late Dr Espag was employed as an anaesthetist and finally retired during 2005. His health was ailing, owing to a disability he suffered from. The first complainant was a housewife.

14. The couple duly consulted the second respondent who had been their financial advisor for a number of years. The first complainant trusted the second respondent completely and sought advice on how to best invest their retirement savings. They believed that the respondent would be acting in their best interest, and specified to him that their savings should be securely invested and the capital protected as they had no means to acquire additional funds should they be lost. The complainants were also concerned about future medical expenses as a result of Dr Espag's condition.

15. On advice of the respondent, the complainants invested in other syndication schemes (Tummah, Blue Pointer, Blue Zone and City Capital[11]). Whilst these investments do not form part of the complaints received by the Office, they are mentioned for the sake of completeness. The Sharemax and PIC investments followed thereafter.

16. During December 2008, the respondent approached the complainants, advising them to invest in Sharemax. He stated that capital return was guaranteed with good growth and income during the investment period. The respondent assured the complainants of the safety of these investments because it was their primary concern. The complainants made the following investments in Sharemax at the time:

    16.1 R350 000 – Zambezi (RH Espag)

    16.2 R350 000 – Zambezi (HP Espag)

17. The respondent approached the complainants during January 2009 to invest in PIC (Highveld Syndication 21). At that stage, their financial outlook was worrying, owing to the Blue Pointer

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[11] The value of the said investments amounted to R2 800 000. The majority of this money was lost.

investment that stopped paying income, and Bluezone irregularities that were constantly in the news. The complainants were concerned about their financial safety, and implored the respondent to invest their money safely (capital and income guaranteed). According to the complainant, by the time the two PIC investments were concluded during June 2009, Tummah and City Capital had been liquidated. The complainants therefore trusted that the respondent, knowing the losses they suffered, would appropriately advise them on future investments.

18. The complainants accordingly proceeded with the PIC investments, on advice from the respondent that the capital and income was guaranteed. The PIC investments are set out below:

    18.1 R375 000 – HS 21 (RH Espag)

    18.2 R375 000 – HS 21 (HP Espag)

19. Notwithstanding the respondent's assurances about the PIC investments, the income was reduced and the complainants informed that it will take a further 5 years for their capital to be refunded.

20. It was approximately a month later when the respondent advised the complainants to make further investments, this time in Sharemax The Villa. The complainants invested an amount of R200 000 each during June 2009, on advice of the respondent.

21. The complainant is of the view that the respondent had inadequate knowledge of the products he sold and consequently misrepresented the investments. Therefore, he acted incompetently and unethically. The complainants seek repayment of their capital.

E. THE RESPONDENT'S VERSION

22. During January 2013, notices in terms of rule 6 (b) were issued, referring the complaints to the respondent to resolve with his clients. There is no record that any response was filed.

23. During June 2015, the Office addressed correspondence to the respondent in terms of Section 27 (4) of the FAIS Act, informing the respondent that the complaints have not been resolved and that this Office had the intention of investigating the matter. The respondent was invited to provide the Office with his case, including supporting documents, in order for the Office to begin its investigation.

24. In response to the said notice, a reply was received from Mr Deon Pienaar, acting on behalf of the respondent. I mention the response by Mr Pienaar for the sake of completeness, but will not deal with it. In a fair number of complaints involving property syndication investments[12], Mr Pienaar filed papers purporting to be acting as *amicus curiae*. Despite numerous responses which clearly state that Mr Pienaar has no legal standing in these matters, he persists in his conduct.

25. Secondly, the issues raised by Mr Pienaar in his papers have already been dealt with by the Court in the matter of *Willem van Zyl & Deon Pienaar v PricewaterhouseCoopers & Others*[13]. The judgement supports the intention of the legislature that providers of financial services cannot avoid their clients' losses where such losses arise out of the provider's failure to comply with the FAIS Act and its subordinate legislation.

26. What was requested of respondent was his response to the claims made by his clients that he failed to appropriately advise them, pointing to a possible breach of the Code. The respondent has not provide any evidence of compliance with the Code, nor an indication that he rendered advice in accordance with the Act.

F. INVESTIGATION

27. On 4 September 2017, the respondent was provided with a further opportunity to address the Office in terms of section 27 (4) of the FAIS Act. The respondent had to reply to specific questions, which are summarised below:

    27.1 The prospectus is a formal legal document providing details about the investment offering to the public. Was the content of the prospectus and the legal requirements understood and explained to the complainant?

    27.2 Property syndications are high risk investments, amongst others, because they are unlisted securities. Being unlisted means that there is a lack of regulatory oversight. Did the

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12 See for example, Mof van Niekerk Makelaars v JPH Robbertse, FAB10/2017

13 Case No.: 12511/2013, Western Cape High Court

complainant understand that investors are at risk as unlisted shares and debentures are not readily marketable and the value is not readily ascertainable?

27.3 The basis upon which valuation of the properties are done are not fully disclosed. Were the valuation figures confirmed?

27.4 The prospectuses are clear that Sharemax was the promoter, the company secretary and property manager with no mention of an independent fund manager. Given the overwhelming conflict of interests, what steps were taken to ensure that clients would not be short changed by the directors of the syndication?

27.5 The prospectus also informs potential investors that there is essentially no independent board of directors. Although it was indicated that a new board would be elected on the first meeting of shareholders, there is no evidence that it occurred. In the absence of an independent board, what steps were taken to protect clients from director misconduct and to ensure that investors' funds were used for what they were intended?

27.6 The oversight of a board includes the appointment of an audit committee whose function, among other things, is to receive assurance from an independent audit firm. An audit committee's oversight includes satisfying itself that the entity has proper controls, and that the information contained in the financial statements of the entity can be relied on. Given the fact that there was no audit committee and no audited financial statements, what information was considered to conclude that the investment was viable?

27.7 Government Notice 459 of Gazette 28690 mandates that investor funds 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 would be withdrawn to fund various activities, on what basis was the product recommended in the face of this high risk?

27.8 What information was relied on to conclude that this investment was appropriate to the 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.

28. The respondent failed to reply to the said notice.

G. ANALYSIS

29. The respondent had an agreement with the complainants in terms of which he rendered financial services to them. The specific form of financial service that these complaints are concerned with is advice[14]. That advice, undoubtedly, had to meet the standard prescribed in the General Code. The complainants acted on this advice.

The law

30. The following sections of the General Code of Conduct are relative to the issue of advice:

30.1 Section 2, part II of 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.

30.2 Section 3 (1) (a) of the Code states that when a provider renders a financial service, that:

(a) representations made and information provided to a client by the provider –

(i) must be factually correct;

(ii) must be provided in plain language, avoid uncertainty or confusion and not be misleading;

(iii) must be adequate and appropriate in the circumstances of the particular financial service, taking into account the factually established or reasonably assumed level of knowledge of the client;

(iv) must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction.

[14] The definition of a financial service in section 1 includes an intermediary service.

30.3 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.

30.4 Section 8 (1) (a) to (d) 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...

30.5 Lastly, section 9 provides for the keeping of a record of advice which must 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...

31. The questions posed in the notices in terms of section 27 (4), had their answers grounded in the prospectuses. Had the respondent paid attention to the content, he would have understood that the investments were not suitable for his client. In respect of the Sharemax investments, I refer to the attached summary of the Zambezi and The Villa prospectuses, the Sale of Business Agreement, (SBA) and Government Notice 459 (Notice 459), as published in Government Gazette 28690. I will also deal with the HS 21 prospectus below.

Zambezi Ltd and The Villa prospectuses

Conflicting provisions

32. In respect of Zambezi, paragraph 19.10 states that funds collected from investors would remain in the trust account, and investors would be paid their return from the interest accumulated therefrom. Paragraph 5.11.2, on the other hand, states that the funds would not remain in the trust account long enough, since 10% would be released after the cooling-off period of seven days to pay commissions[15]. Paragraph 4.3 confirmed that funds would be advanced to the developer in terms of the SBA via the sister company, Zambezi (Pty) Ltd. These payments were in violation of the Notice.

33. From the onset, paragraphs 3.2 and 3.1.1 of the The Villa prospectus make it clear that the directors of Sharemax, who also were directors of all the other Sharemax companies involved in the prospectus had no intention to comply with Notice 459.

34. Section 4.3 makes provision for the disbursement of investors' funds to pay for the entire shareholding in The Villa Retail Shopping Investments (Pty) Ltd (The Villa (Pty) Ltd) from Sharemax. There is no detail as to how this benefited investors. In the same section 4.3, the prospectus discloses that investor funds will be paid out to the seller of the immovable property via a sister company, namely, The Villa (Pty) Ltd and later to Capicol 1, long before the transfer of the immovable property into the name of the syndication vehicle.

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[15] The aforesaid is confirmed in the investment application forms completed by the complainant.

35. The movement of the funds was illegal and a direct affront to the very legislation that was meant to protect investors (refer to section 2 (b) of the Notice). I conclude that respondent must have been oblivious to the risk and could not have appropriately advised complainant in that case.

36. Two problems arise with the proposition that investors' return were paid from the interest generated by the trust account:

36.1 At the time interest payable by the bank on investments made in line with section 78 (2A) did not go beyond one digit. In fact, this office obtained information that the interest payable was between 7.5% and 9.5%[16]. Sharemax promised 10%.

36.2 The prospectus is unequivocal that the funds would not stay in the trust account long enough to have accumulated any significant interest because of the withdrawals to fund commissions and, subsequently, to fund the acquisition of the immovable property.

37. The prospectuses did not hide the universal role of the promoter, highlighting that investors would have no protection whatsoever as the directors would only be accountable to themselves. The investors were therefore at the mercy of the directors.

38. The prospectuses issued by The Villa Ltd and Zambezi Ltd refer to an SBA[17] concluded between Zambezi (Pty) Ltd and the developer Capicol in respect of Zambezi Ltd and Capicol 1 in respect of The Villa. Two types of payments are dealt with in the SBA: payments to the developer and to an agent called Brandberg Konsultante (Pty) Ltd. (Brandberg).

Payments to Capicol[18]

39. According to the agreement, investors' funds were moved from Zambezi Ltd to Zambezi (Pty) Ltd and advanced to the developer of the shopping mall. At the time of releasing the Zambezi Ltd prospectus,

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16 http://www.fidfund.co.za/wp-content/uploads/2016/03/Historical-Credit-Interest-Rates-from-30-01-2014.pdf

17 Note that the SBA in respect of both entities, Zambezi (Pty) Ltd and The Villa (Pty) Ltd carried essentially the same terms but differed in terms of amounts. The developer, however, **was Capicol 1 in respect of Zambezi and Capicol in respect of The Villa**. Both the borrowers and lenders were represented by the same persons.

18 (Capicol 1 in the case of The Villa (Pty) Ltd)

Sharemax had already advanced substantial amounts to the developer in line with this agreement. A brief analysis of the SBA reveals:

39.1 No security existed for the loan; this is clear from reading the prospectus and the agreement.

39.2 The prospectus stated that the asset was acquired as a going concern, however, the building was still in its early stages of development.

39.3 At the time the funds were advanced to the developer, the immovable property was still registered in the name of the developer. Although the prospectus mentioned the intention to register a mortgage loan, there is no evidence that this was done.

39.4 The developer paid interest of 14%, from which Sharemax took 2% and paid the remaining 12% to the investors of Zambezi.

39.5 The agreement is devoid of detail relating to the assessment of the developer's credit worthiness. There was no evidence that the developer had independent funds from which it was paying interest. Besides, if the developer had the financial standing to borrow such large sums of money at 14% per annum, it would have gone to mainstream commercial sources.

39.6 No detail is provided to demonstrate that the directors of Zambezi had any concerns about the Notice 459 violations.

39.7 There are no details regarding the economic activity that generated the 14% return paid by the developer.

40. The only rational conclusion is that the interest paid to investors came from their own capital.

Payments to Brandberg

41. An entity known as Brandberg was paid commission in advance. According to the SBA, the commission had been calculated at 3% of the purchase price. There are no details of how these payments benefited investors. No valid business case is made as to why commission had to be

advanced, in light of the risk to investors. No security was provided against this advance to protect the investors' interests.

42. The payments to Capicol and Brandberg were in violation of Notice 459. These are serious red flags (as comprehensively noted in the annexures) that were apparent from the start and should have led a reasonable person, particularly one in the position of the respondent, to foresee the harm and take steps to mitigate it accordingly[19].

HS 21

43. I refer to the summary of HS 21 annexed hereto and note the following:

43.1 It is alleged in the prospectus that PIC complies with the requirements of Notice 459[20].

43.2 The mandatory risk warning is stated as: The shares on offer are unlisted and should be considered as a business enterprise capital investment. Shares can trade at a lower value, should the company not perform. Further, shares are less marketable.

The statement does not accord with the requirements of Notice 459. According to the Notice, investors shall be advised that there is a substantial risk, in that investors may not be able to sell their shares should they wish to do so. In this regard, it is not the function of the promoter to find a buyer should the investor wish to sell.

43.3 Funds received will be deposited in the trust account of Eugene Kruger & Co Attorneys. The funds will be drawn on the instruction of PIC as per the agreement between PIC and the investors. The unencumbered properties will be transferred into HS 21.

Notice 459 states that investor funds shall be deposited into a registered trust account of a registered attorney or chartered accountant and shall be withdrawn only in the event of registration of transfer or upon underwriting by a disclosed underwriter.

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19 *Van Wyk v Lewis, Durr v ABSA*, case number 424/96, SCA

20 Paragraph 4 of the Director's Prologue

44. What the complainant needed to know was that the directors of PIC had no intention of complying with the Notice. Further, the investment was high risk and not appropriate for the complainants' circumstances.

H. FINDINGS

45. What is clear from the aforesaid information is that the respondent was out of his depth when he recommended the Sharemax and PIC investments to his clients. Furthermore, the respondent could not have acted in the best interest of his clients when he recommended so many property syndication investments (which subsequently failed), and continued to do so even after he became aware of the funds the complainants lost as a result of his advice.
In this respect, the respondent's advice was negligent and in violation of his duty as set out in section 2 of the General Code (the Code). The respondent could therefore not advise his client appropriately, in contravention of sections 3 (1) (a) (i) – (iii) and 8 (1) (a) to (c) of the Code.

46. From the information provided and the lack of relevant records, it is evident that the respondent paid no attention to the complainants' personal circumstances when he considered the suitability of the investments. The respondent was well aware that the complainant had no means to recoup any losses, owing to Dr Espag's ill health and the fact that the first complainant was not employed. Despite the aforesaid, the respondent still considered the property syndication investments to be appropriate. In the absence of a record in terms of section 9 of the Code, there is no justification or explanation as to why the said investments prevailed.

47. 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 a full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision.* The probability favours the complainant's version that she was not advised of the risk involved in the product, and more so, because the respondent himself did not understand the risks.

48. As a consequence of the aforesaid breach of the Code, the respondent committed a breach of his agreement with the complainants' in that he failed to provide suitable advice. The respondent must

have known that the complainants would rely on his advice as a professional in effecting the various investments.

49. It stands to reason that the respondent caused the complainants' loss.

I. RECOMMENDATION

50. The FAIS Ombud recommends that the respondent considers the questions raised in the respective notices and pay the complainants as noted below:

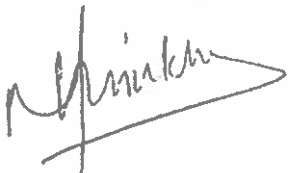
50.1 First complainant – R925 000

50.2 Second complainant – R700 000

51. The respondents are invited to revert to this Office within TEN (10) days with their response to this recommendation. Failure to respond will result in a determination being made in terms of Section 28 (1) of the FAIS Act[21].

52. The complainants, upon full payment, must cede all their rights and title to the investments to the respondent.

Yours sincerely



ADV M WINKLER

ASSISTANT OMBUD

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21 *"The Ombud must, in any case where a matter has not been settled or a recommendation referred to in section 27(5)(c) has not been accepted by all parties concerned, make a final determination, which may include-*
(a) the dismissal of the complaint; or
(b) the upholding of the complaint, wholly or partially...."