

OUR REFERENCE: FAIS 03378/12-13/ KZN 1

7 September 2017

ATTENTION: Mr Stephanus Johannes Du Preez

The Meadow Group

Per email: mvz@wmdconsult.co.za

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Dear Mr Du Preez

Mrs Talita Hough v Fanie Du Preez Makelaars CC t/a The Meadow Group (first respondent) and Mr Stephanus (Fanie) Johannes Du Preez (second respondent). RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT, (ACT 37 of 2002)

A. INTRODUCTION

1. On 2 August 2012, Mrs Talita Hough filed a complaint with this Office against The Meadow Group and one of its key individuals, Mr Stephanus (Fanie) Johannes Du Preez. The complaint arose from a failed investment by the complainant in 2010, on the advice of the second respondent, into a public property syndication scheme, namely, The Villa Ltd, promoted by Sharemax Investments (Pty) Ltd (hereinafter referred to as "Sharemax").
2. During July 2010, the investment stopped paying income. Around that same time, news that Sharemax was experiencing financial troubles, along with claims that the South African Reserve Bank had launched an investigation into Sharemax's affairs were doing its rounds. Complainant considers her capital lost.

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Fairness in Financial Services: Pro Bono Publico

Delays in finalizing this complaint

3. I find it important to address the delay in finalising this complaint. Sometime in September 2011, after the Office issued the *Barnes* determination¹, the respondent in that matter brought an urgent application to set aside the determination². Before the fate of the application could be known, respondents sought an undertaking from this Office that it would not proceed with any other property syndication related complaints involving them.
4. Since no legal basis existed for respondent's demands, the Office proceeded to determine further property related complaints, to which respondents replied 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, favouring the Ombud, was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*³.
5. The Office continued to determine complaints involving property syndications after the High Court decision⁴. However, in 2013, following the *Siegrist* and *Bekker* determinations⁵ and the relevant appeals, 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 appeals was finally decided in April 2015⁶, after which the Office resumed processing complaints involving property syndications with due regard to the decision. As many as 2000 complaints had to be shelved during this period, pending the Appeals Board's decision.

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

² Respondent claimed that section 27 of the FAIS Act was unconstitutional
³ Gauteng High Court Division, case number 50027/2014

⁴ Referred to in paragraph 3

⁵ See in this regard FAIS-00039-11/12 and FAIS-06661-10/11.

⁶ See in this regard the decision of the Appeals Board date 10 April 2015.

B. THE PARTIES

6. The complainant is Mrs Talita Hough, an adult female teacher, 40 years of age at the time. The complainant's full details are on file in this Office.
7. First respondent is Fanie Du Preez Makelaars CC t/a The Meadow Group, a close corporation duly incorporated in terms of South African law, with registration number (1995/039060/23). The first respondent is an authorised financial services provider (FSP) (licence number 15422), with its principal place of business noted in the Regulator's records as 73 6th Avenue, Newton Park, Port Elizabeth, 6001. The licence has been active since 26 November 2004.
8. Second respondent is Stephanus (Fanie) Johannes Du Preez, an adult male, key individual and representative of the first respondent. The Regulator's records confirm his address to be the same as that of first respondent. At all times material hereto, second respondent rendered financial services to the complainant.
9. I refer to the respondents collectively as "respondent". Where appropriate, I specify which respondent is being referred to.

C. THE COMPLAINT

10. At a meeting held on 30 March 2010, complainant together with her father, met with the second respondent to discuss possible investments. The meeting which had been at complainant's instance, was to seek advice with regards to investing an amount of R10 000.
11. Complainant claims to have advised Mr Du Preez that she required a regular monthly income and that her capital be guaranteed. Respondent, in the presence of the complainant's father, recommended that complainant invest into Sharemax Investments (Pty) Ltd in property syndication known as The Villa Retail Park Holdings Limited 19, (The Villa Ltd).

12. Subsequent to this meeting and as a result of respondent's recommendation, complainant invested R10 000 into The Villa Ltd on 31 March 2010. The funds had been the proceeds of complainant's annual performance bonus.
13. Complainant further claims that at the above-mentioned meeting, respondent had completed a Risk Profile Analysis for complainant that indicated that she was a moderate investor, who invests for long term and wanted reasonable but relatively stable growth. Respondent's risk analysis according to complainant meant that she could tolerate some fluctuations but still required less risk than a full equity based investment.
14. Complainant describes herself as an inexperienced investor. She states that subsequent to the loss of her funds and after having had an opportunity to re-consider the Risk Profile Analysis, she was of the view that it was designed to obfuscate and lead prospective investors towards a particular investment. Complainant is further of the view that it did not represent a genuine or adequate attempt to meet her investment requirements and did not accord with her requirement for a low risk investment that would guarantee her capital.
15. During July 2010, complainant received the last income instalment after which it suddenly stopped. Complainant claims that all her efforts to resolve the matter with the respondent were futile.
16. Complainant charges that the respondent failed to advise her of the high risks involved in the Sharemax investment. She was also not warned that she could lose her capital.
17. Complainant also re-emphasized her claims that respondent had allegedly provided verbal assurance that her capital was guaranteed.

D. RESPONDENT'S VERSION

18. Respondent's reply was received on 17 September 2012 following our Rule 6 (b) letter of 7 August 2012. The salient features of respondent's reply appear in the paragraphs immediately below:

- 18.1 Respondent claimed that there were material disputes of fact between his version and that of complainant with regards to what transpired. Respondent individually referred to each allegation raised by complainant and claimed that they were all contradicted by the documentation provided.
- 18.2 Respondent claims to have conducted due diligence into the proposed investment which included: considering the proposed investment vehicle and the promoter, investigating the information provided by the promoter inclusive of the prospectus issued, analysing any established track record of the promoter and/or the investment and determining whether the proposed investment was properly licenced by the FSB. The claims made by respondent in this paragraph must have shed some light for respondent about the risks that were posed by The Villa investment.
- 18.3 Respondent claims that complainant had approached him during March 2010 together with her father. The latter, according to respondent, had made a number of investments into various property syndications including The Villa. Complainant had allegedly claimed that she was there on the recommendation of her father and that she was not interested in being assisted with anything other than an investment into The Villa.
- 18.4 Respondent further stated that complainant had R10 000 available to invest for what she had referred to as 'long term capital growth funds'. Respondent was of the view that complainant was still relatively young and that she had indicated that she had sufficient investments and insurance products to take care of her needs. One must point out at this stage that these statements by respondent are not supported by any contemporary record produced at that time. On the contrary, complainant advises that at the inception of this investment, she had neither investment nor insurance policies and that this transaction represented her only investment.
- 18.5 In summary respondent was of the view that complainant had already satisfied herself that an investment into The Villa was suitable and appropriate for her circumstances, and that the service required from him was to address a single need to invest for the long term.
- 18.6 Respondent claims to have provided full disclosures with regards to The Villa and that complainant fully understood the nature and type of the proposed investment. In support of

these claims, respondent makes reference to specific documents both read and signed by complainant. These documents are listed here below:

- The 'Letter of Disclosure' together with a copy of respondents FSB licence in support of his credentials as a registered financial services provider.
- The 'Client Consent to Obtain Information [and] Appoint New Broker' form.
- A 'General Client Advice Declaration': it is noted by respondent that complainant had been made aware of the risk and limitations of the advice in not conducting a financial needs analysis, and that complainant had read and understood all information presented to her in the form of the prospectus, the quotation with regards to costs, liquidity limitations, and material aspects of the investment.

I note that this is a standard, pre-populated document that provides no indication as to the nature of the disclosures that were made to complainant to have assisted her in making an informed decision.

- The 'Client Advice Record' (this was in fact presented as a 'Service Agreement' in documents provided by respondent) which respondent claims confirms the nature of the transaction as being a single need stemming from a specific request by complainant.
- In the section marked 'Specific Client Request' one would expect respondent to have noted that complainant had specifically requested the investment at the expense of other recommendations made. There is no such record. This document also confirms that there were no initial, or management fees, and that all costs had already been taken into account. Confusing as the statement is, it simply does not amount to a disclosure that respondent was paid 6 % commission (amounts to R600)⁷, payable out of complainant's invested capital.
- A document titled 'Verklaring'. Notwithstanding respondent's claims of what the document purports to be, this document requires complainant to confirm, having

⁷ In terms of the Code the amount payable to respondent would have been R600 rand and this is what the Code demands in terms of disclosure by a provider when rendering financial services, especially where the rand value is easily determinable.

been made aware of the risk involved in the generation of income and capital growth, that she understood the workings, advantages, disadvantages and risks associated with the investment. The document however falls short of providing any detail of what the risks are.

- The 'Sharemax Investments Risk Analyser and Product Information': this is supposed to confirm that important aspects of the investment had been discussed and disclosed to complainant. It is also deemed to have included an acknowledgement by complainant that the investment was for the medium to long term and that complainant had sufficient cash reserves for any unforeseen expenses.

This document, despite it being a risk profiling tool, provides no conclusion as to complainant's risk profile and the suitability of the investment to the complainant.

- Respondent is of the view that the 'Risk Profile' document contains complainant's confirmation that she did not require a guarantee. This is based on complainant not having ticked the option under section 3 of the 'Risk Profile' and that complainant had selected the option under question 7, i.e., that she was prepared to accept short-term losses, and that she had wanted her investment to keep track with inflation.

It is noted that question 3 asks what complainant's primary financial goal is. It cannot be accepted that by choosing income above capital protection, where only one choice is required, translates into complainant not having required that her funds be guaranteed. Furthermore, question 7 asks whether complainant is prepared to accept short term losses, this too cannot be accepted as proof of complainant not having required a guarantee because the context within which this question is asked refers to good long term returns.

Respondent ultimately concluded that the complainant was a moderate investor, and the recommendation of The Villa syndication would therefore suggest that respondent viewed the investment as suitable to the identified risk. This flies in the face of the risk evidenced by the prospectuses and, more so, by the warnings that are apparent in the opening pages. On the strength of this paragraph alone,

respondent then provided advice to the complainant and pointed her to The Villa as a suitable investment for her risk profile.

18.7 Respondent concluded the response by raising a number of issues that he believed precluded this Office from investigating the matter.

E. INVESTIGATION

19. On 12 June 2015, this Office sent notices to the respondents in terms of section 27 (4) of the FAIS Ac, (the Notice), informing respondents that the complaint had not been resolved and that the Office had intention to investigate the matter. The letter reads (omitting for now words not material to the essence):

19.1 *The prospectuses of both the Villa Retail Park Holdings as well as Zambezi..... declare that the respective entities have never traded prior to the registration of the prospectus, have not made any profit whatsoever and are still under construction.*

19.2 *In the circumstances, how did you expect the income to be paid, other than out of investors' money?*

19.3 *The prospectuses refer to the investment as being an unsecured subordinated interest rate acknowledgement of debt linked to a share, which share was in an entity still under construction.*

19.4 *Given the preceding paragraph please advise as to why you considered the investment to be anything less than an extremely risky venture, without any substance to its guarantee on interest payments?*

19.5 *Was your client properly apprised of these risks? Please provide evidence to this effect.*

19.6 *What information did you rely on to conclude that this investment was 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.*

20. Respondent was invited to substantiate his answers with documents compiled at the time of providing advice to his clients.

21. Respondent replied to the Section 27(4) Notice on 29 June 2015. The response is summarised below:
- 21.1 The respondent referred to his initial response provided on 17/09/2012 which he stated was a comprehensive and proper response. Notwithstanding this, respondent did reply to the specific questions raised in the above-mentioned notice.
- 21.2 Respondent reiterated that the investment represented a single need for long term growth and that it had been made, as he put it, at the 'behest' of complainant's father, who was also a client of respondent and investor in The Villa syndication. Respondent remained adamant that complainant had never requested, or required, a guaranteed investment.
- 21.3 Respondent reiterated claims that complainant was relatively young and had sufficient investments and insurance to address her needs, and that despite respondent having provided her with alternative options '...with commercial banks and Sanlam', complainant had wanted to invest in the same investment as her father. Respondent provided no record to support these claims.
- 21.4 Respondent claims to have explained to complainant the nature of Sharemax's business which was about "...developed and administered syndicated and unlisted properties." Respondent was satisfied that the due diligence he had conducted was sufficient to determine that the investment was suitable to complainant's circumstances.
- 21.5 Respondent once again referred to the documentation completed by complainant which has been comprehensively dealt with above.
- 21.6 In response to specific questions raised in the notice with regards to The Villa, respondent claims that the prospectus of the investment was provided and explained to complainant and that she had understood and accepted the nature and workings of the investment and the associated risks.
- 21.7 Referring to paragraph 4 of the Sharemax prospectus and the Sale of Business Agreement (SBA) with Capicol 1, respondent refutes the claims that income was payable from investors capital. Respondent also made the point that the track record of Sharemax as a promoter illustrated to the potential investor the viability of the investment model.

F. ANALYSIS AND RECOMMENDATION

22. I have noted the statements by respondent that there are disputes of fact in this matter. However, there remains substantial common ground with undisputed facts to determine this matter.
23. First, I note that despite respondent's statement that, upon meeting complainant, he formed the view that she had already satisfied herself as to the suitability of the investment to her circumstances, he, on his own version, decided to carry out a risk profile analysis.
24. It is as a result of respondent's risk profile analysis that complainant was identified as a moderate investor. I must stress that despite the claim that complainant had asked for The Villa, respondent had the opportunity to caution complainant and record that the investment being considered was not suitable for the complainant's risk profile as a moderate investor. He did not. The failure to record the warning as demanded by section 8 (4) (b) of the Code, could have only meant that respondent found the investment suitable for complainant's circumstances, risk capacity and tolerance⁸. In other words, despite respondent's claims that complainant had requested to invest in The Villa, on his own version, he recommended an investment in The Villa following his risk analysis.
25. Quite apart from the risk analysis, there is ample ground in respondent's version to demonstrate that he advised complainant about The Villa investment and claims to have discussed several aspects of the investment, informing complainant of the risk inherent in the investment, the illiquid nature of the investment and some reference to cost. The advice provided by respondent therefore had to meet the standard prescribed in the FAIS Act and the General Code. For the purposes of this case, the following sections of the Code are germane.
26. 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

⁸ Section 8 (1) (c) of the General Code

of clients and the integrity of the financial services industry. I note that respondent on his own version had carried out a due diligence exercise.

27. 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...*

28. Section 8 (4) (a) and (b) of the General Code states that:

'Where a client-

(a) has not provided all information requested by a provider furnishing advice, as part of the analysis referred to in subsection (1) (b), or where the provider has been unable to conduct such an analysis because in the light of the circumstances surrounding the case, there was not reasonably sufficient time to do so, the provider must fully inform the client thereof and ensure that the client clearly understands that-

- (i) a full analysis in respect of the client referred to in subsection (1) (b) could not be undertaken;*
- (ii) there may be limitations on the appropriateness of the advice provided; and*
- (iii) the client should take particular care to consider on its own whether the advice is appropriate considering the client's objectives, financial situation and particular needs;*

or

(b) elects to conclude a transaction that differs from that recommended by the provider, or otherwise elects not to follow the advice furnished, or elects to receive more limited

information or advice than the provider is able to provide, the provider must alert the client as soon as reasonably possible of the clear existence of any risk to the client, and must advise the client to take particular care to consider whether any product selected is appropriate to the client's needs, objectives and circumstances.'

29. I refer to the attached annexures, being summaries of The Villa Ltd prospectus, the Sale of Business Agreement (SBA), and Government Notice 459 (Notice), as published in Government Gazette 28690. With these documents, I demonstrate that, despite respondent's claims of disclosing the risk, there was no basis for him to have recommended the high risk Villa Ltd investment. In this regard, I note that I have not found any record of the type anticipated by section 8 (4) (b) of the Code.
30. The requirements of this section were not meant to benefit complainants but respondents as well. All that was required of respondent following the risk analysis and the alleged pre-conceived idea to invest in The Villa on the part of complainant, was a note warning complainant of inherent risks in this investment. Respondent was obliged to note that the investment was simply not consistent with complainant's risk profile as a moderate investor. Even if one forgets the label of moderate investor, respondent was obliged to note in his records that complainant had been warned that because of the high-risk nature of the investment, she could lose all her capital. Respondent's records demonstrate objectively that this was not done. I note again that there is no dispute in this regard.
31. I also feel compelled to deal with respondent's reference to complainant having agreed to invest for a long term, the fact of the matter is that respondent has provided no credible evidence that complainant, despite the overwhelming evidence, has not lost her investment. I now deal with the risks involved in this investment.

The Villa Ltd

Violations of Notice 459

32. From the onset, paragraphs 4.3 of The Villa Ltd prospectus made it plain that the directors of Sharemax, who also were directors of all the other Sharemax companies involved in the prospectus, had intention to violate Notice 459.

33. In this regard, the prospectus made provision for disbursing investors' funds to pay Sharemax, for the entire shareholding of The Villa Retail Shopping Investments (Pty) Ltd (The Villa (Pty) Ltd). There is no detail of the concomitant benefit for investors and neither is the full purchase price noted anywhere in the prospectus.
34. The prospectus disclosed (in paragraph 4.3) that investor funds will be paid out to the seller of the immovable property, Capicol 1 via The Villa (Pty) Ltd, well before registration of transfer of the immovable property into the name of the syndication vehicle.
35. The movement of the funds was illegal and a direct affront to the Notice (see Annexure A3, which contains a summary of section 2 (b) of the Notice). The respondent, even in his answers to this office, says nothing about the infringement of the Notice. I note that respondent's due diligence must have uncovered this upon reading the prospectus.

Conflicting provisions of the prospectus

36. I refer also to the conflicting provisions of the prospectus; in this regard paragraphs 19.10 and 4.3. First, paragraph 19.10 states that funds collected from investors would remain in the trust account in terms of section 78 2 (A) of the Attorneys Act. Investors' returns would be paid from the interest generated by the trust account. Paragraph 4.3 however, conveys that the funds would not stay long enough in the trust account because 10% would be released after the cooling off period of seven days to pay commissions. The same statement is made in the application forms that clients had to complete in applying for the investment. This payment also violated the Notice.
37. There are two problems with the proposition that the investor's return was paid from the interest generated by the trust account. They are:
 - 37.1 At the time, the 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 at the time was between 5.9% - 7%⁹.

⁹ <http://www.fidfund.co.za/banking-options/credit-interest-rate-history/>

37.2 The prospectus is unequivocal that the funds would not stay long enough in the trust account to have accumulated any significant interest because they were withdrawn, firstly after seven days to fund commissions and subsequently, to fund the acquisition of the immovable property.

37.3 The prospectus states that the interest payable on the claim component of the unit will be determined from time to time by the directors¹⁰.

Sale of Business Agreement (SBA)

38. The prospectus issued by The Villa refers to a Sale of Business Agreement (SBA), concluded between The Villa (Pty) Ltd and the developer, Capicol 1 (summary attached, annexure A4). Two types of payments are dealt with in the SBA. They are: payments to the developer and an agent, Brandberg Konsultante (Pty) Ltd. (Brandberg).

Payments to Capicol

39. According to the agreement, investors' funds were moved from The Villa Ltd to The Villa (Pty) Ltd and advanced to the developer of the shopping mall. The payments were made well before transfer of the immovable property, and thus were in violation of the provisions of Notice 459. At the time of releasing the prospectus of The Villa, Sharemax had already advanced substantial amounts to the developer in line with this agreement (see paragraph 4.23 of The Villa prospectus). A brief analysis of the business agreement reveals:

39.1 No security existed for the loan in order to protect investors; this is clear from reading the prospectus and the agreement.

39.2 The prospectus states that the asset was acquired as a going concern, yet 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 it was registered.

¹⁰ See paragraph 9.3.1

- 39.4 The developer paid interest of 14%, from which Sharemax took 2% and paid the remaining 12% to the investors of the Villa.
- 39.5 The agreement is devoid of detail relating to the assessment of the developer's credit worthiness.
- 39.6 No detail is provided to demonstrate that the directors of the Villa 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.
- 39.8 The conclusion is ineluctable that the interest paid to investors was from their own capital.
40. There was also no evidence that the developer had independent funds from which it was paying interest; besides which, 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.

Payments to Brandberg

41. An entity known as Brandberg was paid commission in advance. The commission is said to have been calculated at 3% of the purchase price of R2 900 000 000 according to the SBA. There are no details of the benefit to investors for paying the amounts to this entity. No valid business case is made as to why commission had to be advanced in light of the risk to investors. There was also no security provided against this advance to protect the interests of the investors.
42. It is plain from the respondents' reply that this risk was not properly disclosed. He could not have appropriately advised complainants in that case.

G. FINDINGS

43. On the basis of the reasoning set out in this recommendation, the risks in the investment were not disclosed, violating Section 7 (1). 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”.

44. Respondent further violated the Code in terms of section 8 (1) (a) to (c) and section 2.
45. Respondent failed to provide complainant with a recommendation that was appropriate to her needs and circumstances. There is no indication that respondent had adhered to the provisions of section 8 (4) of the Code.
46. The representations made to complainant were incorrect and in violation of section 3 (1) (a) (vii) of the Code.

H. CAUSATION

47. The question must still be answered whether respondent’s inappropriate advice caused the loss. I note that from the facts of the case, respondent recommended an investment in The Villa. That recommendation was by all account taken up and acted upon by complainant. In other words, complainant must have relied on the advice of respondent when she made the investment.
48. The inappropriate advice was a breach of the Code and consequently, a breach of respondent’s duty to appropriately advise in terms of his agreement with complainant¹¹.
49. There is no doubt that had the complainant been made aware of the risks involved in this investment, she would in all likelihood not have invested.

I. RECOMMENDATION

50. The FAIS Ombud recommends that the respondent pay the complainant’s loss in the amount of R10 000.

¹¹ See in this regard Robert Ludolf Prigge v J & G Financial Services Assurance Brokers (PTY) LTD and James Wright FAIS 03440/11-12/ GP 1- paragraphs 43-44

51. The respondent is invited to revert to this Office within TEN (10) working days from date hereof with a response to this recommendation. Failure to respond with cogent reasons will result in the recommendation becoming a final determination in terms of section 28 (1).
52. Interest at the rate of 10.25 % shall be calculated from a date TEN (10) days from date of this recommendation.

Yours sincerely



Marc Alves
Team Resolution Manager