FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS 01444/11-12/ WC 1

FAIS 02545/11-12/ WC 1

7 November 2017

MR MC HOLTZHAUSEN

WANADOO 30 CC t/a MARTIN HOLTZHAUSEN FINANCIAL SERVICES

Per email: m.c.holtzhausen@absamail.co.za

BAREND JOHANNES VILJOEN & HERMINA FRANCISCA VILJOEN v WANADOO 30 CC t/a MARTIN HOLTZHAUSEN FINANCIAL SERVICES and MARTIN HOLTZHAUSEN: RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT 37 OF 2002

A. INTRODUCTION

1. The first and second complainant are married to each another and were retirees aged 75 and 67 respectively at the time of advice. Two investments were made by the complainants in April 2006 and in December 2008 into two Sharemax property syndications, on the strength of advice provided by the respondents that Sharemax was a safe investment and that their capital would be guaranteed. The complainants claim to have impressed upon the respondents that they needed safe investments that would guarantee their capital and a monthly income of a minimum of R3000.

2. When the investments began to falter, the complainants made attempts to resolve the matter with the respondent to no avail.

3. Following several failed attempts to recover their capital, the complainants lodged this complaint against the respondent alleging that he had failed to advise them appropriately. The complainants asked for the full amount of their capital of R520 000 to be paid by the respondents.

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B. THE PARTIES

4. The first complainant is Mr Barend Johannes Viljoen, an adult male pensioner whose particulars are on file with this Office. The second complainant is Mrs Hermina Francisca Viljoen, an adult female pensioner whose particulars are also on file with this Office.

5. The first respondent is Wanadoo 30 CC, t/a Martin Holtzhausen Financial Services, a close corporation duly incorporated and registered with registration number 2001/062169/23. The regulator's records confirm the first respondent's principal place of business as 14 Ronald Street, Dormehlsdrift, George, 6529. The first respondent is an authorised financial services provider with licence number 13006. The licence has been active since 15 December 2004.

6. The second respondent is Martin Holtzhausen, an adult male, and key individual and representative of the first respondent. The second respondent's address is the same as that of the first respondent.

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

8. I refer to the first and second complainants as "the complainants", and to the first and second respondents as "the respondent". Where appropriate, I specify.

C. DELAYS IN FINALISING COMPLAINTS OF THIS NATURE

9. In view of our mandate to resolve complaints expeditiously, among 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 in September 2011, after the Office issued the *Barnes* determination[1], the respondent in that matter brought an urgent application to set aside the determination[2]. 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.

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

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

10. Since no legal basis existed for the respondent's demands, the Office continued to determine further property-related complaints, to which the respondents responded 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*[3].

11. The Office continued to determine complaints involving property syndications after the High Court decision. However, in 2013 and following the *Siegrist* and *Bekker* determinations[4] 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[5], after which the Office resumed the processing of complaints that involved property syndications with due regard to the decision. As many as 2000 complaints had to be shelved pending the Appeals Board decision.

D. THE COMPLAINT

12. The first complainant retired in 1993 at the age of 61. Prior to his retirement, he was employed as an Assistant Manager with Trust Bank. His investment experience was limited to banking products liked fixed deposits. At the time of his retirement, complainant had never heard of property syndications. The second complainant was a homemaker all her life. The complainants were therefore reliant on the advice of respondent to make an informed decision.

13. There appears to be no dispute that two investments were made by the complainants on the basis of advice furnished by the second respondent. That advice, according to the complainants, met their requirements of a five-year-term investment that would guarantee their capital while paying them a monthly income of R3000.

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3 Gauteng High Court Division, case number 50027/2014

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

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

14. It is common cause that the first complainant invested an amount of R400 000 on 13 April 2006 into a Sharemax scheme known as the Shopmakers Village Holdings Ltd, (Shopmakers Ltd). The agreed return according to the complainants was set at 9% of the invested capital.

15. There appears to be no dispute that at the time of making the investment, the complainants had not been furnished with the relevant prospectus of Shopmakers Ltd. Both the complainant and the respondent have provided different reasons for the prospectus not being provided. For the record, nothing turns on these reasons. The first complainant of his own accord sent the respondent a note recording his understanding of the investment as explained in their meeting.

16. In December 2008 and upon being offered what the respondent allegedly described as an "opportunity of a lifetime", the second complainant invested R120 000 into Sharemax Zambezi Ltd. The complainants allege they were advised that the investment would generate a net profit of 30% within 12 months and that the capital was guaranteed. The complainants further allege they were informed that the building that was central to the Zambezi Ltd scheme had already been sold and their capital would be returned after 12 to 14 months[6].

17. The capital in respect of the Zambezi investment was not returned at the end of 2009 as the complainant was led to believe it would. Furthermore, the investment in Zambezi began to falter, in that monthly interest payments stopped in August 2010. During September 2010, the payments in respect of Sharemax Shopmakers Village drastically reduced from R3000 monthly to approximately R1145, until it ceased in July 2013. At the time the complainants lodged their complaint, the entire capital of R520 000 invested in Sharemax had not been returned.

18. The complainants asked the Office for an order against the respondent to repay their capital of R520 000 for failing to provide them with suitable advice.

[6] The application form confirms that complainant elected option A, being the income plan.

E. THE RESPONDENT'S VERSION

19. During July and September 2011, notices in terms of rule 6 (b) were issued referring the complaint to the respondent to resolve it with his clients. The complaint was not resolved. The respondent's reply is summarised as follows:

19.1 The complainants visited the respondent and asked for an investment with maximum income. Although their risk profiles confirmed them to be conservative investors, they insisted on an income that was higher than income offered by institutions such as Sanlam, Liberty and Clientele.

19.2 The prospectus for Shopmakers was available online; however, the complainants allegedly declined a printed copy.

19.3 The marketing costs and a commission payable to the respondent amounting to 6% were explained to the complainants. In so doing, the complainants were advised that these costs were paid by the promoter and not from the complainant's capital. This statement by the respondent is factually incorrect. Both the prospectus and the investment application form make it plain that the promoter would deduct 10% from the proceeds of the sale of shares to fund marketing costs[7].

19.4 The respondent was of the view that the complainant's letter of 17 April 2006[8] in which the latter confirmed his understanding of the investment is sufficient proof that the complainants understood the concept of the syndication.

19.5 In conclusion the respondent believed that the complainant's unhappiness stems from the negative impact that the Reserve Bank's intervention had on his income. The respondent concluded his letter by stating that he believes he complied with the Act and the Code.

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[7] See in this regard paragraphs 5.9 and 12.3 of the Shopmakers prospectus

[8] The letter stated in short that:
a. Sharemax Investments (Pty) Ltd purchases the building for R50 000 000, which equates to the investment value
b. The investment therefore presents 50 000 shares at R1000 per share
c. The complainant's investment of R400 000 represents 400 shares, which equates to 8% of the total value of the investment. The complainant therefore owns 8% of the properties

20. During May 2012 and September 2015 respectively, the Office addressed correspondence to the respondent in terms of Section 27 (4) of the FAIS Act, informing the respondent that the complaint had 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.

21. The respondent replied on 16 May 2012 that he had already responded to the matter and considered the case closed. He alluded to the fact that the complainants had insisted on the high income, despite knowing the risks. He added that the first the complainant had been a senior bank manager for many years. For this reason he knew more than anyone else about risk and the differences between a Sanlam investment and the Sharemax investment.

F. INVESTIGATION

22. On 21 April 2017, the respondent was provided with a further opportunity to address the Office in terms of section 27 (4) of the FAIS Act. The specific questions raised (omitting words not essential) are set out below:

- *Property syndications are high-risk investments because they are structured as unlisted companies, among other reasons. The basis upon which the properties are valued is never fully disclosed. Did you 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, the loss could be the investor's entire investment. Did you explain this to your client?*

- *The prospectus….. makes it plain that Sharemax 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 would not be short changed by the directors of the syndication?*

- *The prospectus further informs potential investors that, essentially, no independent board of directors exists. There is a clause stipulating that a new board will be elected on the first meeting of shareholders; however, there is no evidence that the election occurred. 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 would be protected against director misconduct?*

- *Given the absence of an independent board, how were you going to ensure that investor funds would be 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, 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 did you take into account to conclude that the investment was viable?*

- *You may be aware that Government Notice 459 of Gazette 28690 mandates that investor funds are to 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 advanced to a developer, what made you recommend the product to your client in the face of this high risk?*

- *We would like you to spell out the steps you took to understand the risk involved in this product, including how you apprised your client of these risks.*

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

23. The respondent's only reply to this notice was that he had responded before and considered the case closed.

G. ANALYSIS

24. The respondent does not deny that he had an agreement with the complainants in terms of which he rendered financial services to them. The specific form of financial service that this complaint is concerned with is advice[9]. That advice, undoubtedly, had to meet the standard prescribed in the General Code. The complainants acted on this advice and that issue is not disputed.

The law

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

25. 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.

26. Section 3 (1) (a) of the Code provides 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.

27. 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 –

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

(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) (b) states that where a client *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. The questions posed in the notices in terms of section 27 (4) sent by this Office to the respondent had their answers grounded in the prospectuses. Had the respondent paid attention to the prospectuses he would have understood that the investments were not suitable for his conservative clients. It is the respondent's version that despite the complainants' conservative risk status they insisted on high income, which is what led to the decision to invest in the Sharemax schemes. I record for now that in spite of a diligent search, I could find no record of the type envisaged by the Code in section 8 (4) (b)[10].

For the purposes of the analysis, I refer to the attached annexures, being summaries of the prospectus of Shopmakers Village Ltd, Zambezi Ltd, the Sale of Business Agreement, (SBA) and Government Notice 459 (Notice 459), as published in Government Gazette 28690.

[10] Refer to paragraph 27 above

Shopmakers Ltd Prospectus

30. From the onset, the prospectus declared that the directors of Sharemax (the promoter) had no intention to comply with Notice 459. To illustrate this point, I refer to paragraph 19.10 of the prospectus, which states that all moneys received in terms of the offer would be kept in a separate interest-bearing account opened and controlled by the attorneys for each and every applicant. In terms of section 78 (2A) of the Attorneys Act, the moneys would remain in this interest-bearing account until (in respect of successful applicants) the minimum subscription was received and the immovable property had been transferred to Shopmakers Village Investments (Pty) Ltd – the property syndication vehicle. The prospectus in paragraph 4.3, however, states that the Company would operate as a holding company and intended using the offer to advance loan funding to purchase the immovable property way before registration of transfer of the immovable property into the name of the syndication vehicle.

31. The movement of the funds was illegal and a direct affront to the very legislation that was meant to protect investors. I conclude that the respondent must have either turned a blind eye to the risk that investors were exposed to or that he simply could not appreciate the risk at all.

32. Further to this affront to legislation, there is no evidence that an independent board of directors ever existed in the entire group of Sharemax. To this extent, Sharemax played the role of the property manager, transfer secretary, and manager of investor funds[11]. The respondents failed to recognize the obvious conflict of interest that the directors faced as they went about their daily duties. With no evidence of independent oversight, it is fair to conclude that investors would have no protection whatsoever and were at the mercy of executive directors who were accountable only to themselves.

Zambezi Ltd prospectus

Conflicting provisions of the prospectus

33. First, 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

[11] See paragraphs 3.2, 3.3.1, 3.5, 3.10, 3.12, 3.13, 3.14 and 13.2

10% would be released after the cooling-off period of seven days to pay commissions[12]. 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.

34. Two problems arise with the proposition that the investor's return was paid from the interest generated by the trust account:

34.1 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 at the time was between 7.5% and 9.1%[13]. Sharemax promised 10%.

34.2 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.

35. The prospectuses issued by The Villa Ltd[14] and Zambezi Ltd refer to an SBA[15] 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[16]

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

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

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12 The aforesaid is confirmed in the investment application forms completed by the complainant.

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

14 Another property syndication scheme promoted by Sharemax

15 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.

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

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

36.3 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.

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

36.5 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.

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

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

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

Payments to Brandberg

37. 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.

38. 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[17].

The Code

39. Notwithstanding confirmation that the complainants' risk profile was conservative, the respondent still recommended Sharemax as an appropriate investment for his clients. In his explanation of why his client's needs could only be addressed by means of property syndication products, the respondent argued that the Sharemax property syndication offered the highest return. The respondent had a duty to advise his clients of the consequences of chasing high income and to complete the record required by section 8 (4) (b). As already alluded to, there is no such record in the respondent's papers. The probability favours the complainant's version that they were not advised of the risk involved in these products. That version is confirmed by the respondent's reply to this Office, which is devoid of all the risks discussed in this recommendation.

40. 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.*

H. CAUSATION

41. The respondent was well aware of the complainants' financial status and their circumstances, specifically that they had no reasonable prospect of recovering any losses they might suffer should an investment fail. Despite the complainant's circumstances, the respondent still considered the investments in Sharemax to be appropriate. There was no diversification for the purposes of minimising risk and no justification or explanation in terms of section 8 (1) (a) to (c) as to why the Sharemax investment prevailed.

[17] *Van Wyk v Lewis, Durr v ABSA*, case number 424/96, SCA

42. No evidence exists that the respondent had an appreciation of the risk involved in these investments, which leaves me to conclude that the respondent failed to advise the complainant appropriately.

43. The respondent had a duty to advise his clients that:

43.1 the product was high risk and not suitable for them;

43.2 information provided in the prospectuses was conclusive about the investors carrying all the risk;

43.3 the prospectuses undermined the provisions of Notice 459, the very legal measures that are designed for the protection of the investors;

43.4 there were significant and apparent governance flaws, which pointed to the fact that investors would have no protection from the onset; and,

43.5 collectively, the above-mentioned concerns presented compelling reasons to suggest that the complainant could lose their capital.

44. I conclude that it was the respondent's inappropriate advice that caused the complainant's loss. Had the respondent adhered to the Code, no investments would have been made in Sharemax.

I. FINDINGS

45. The respondent violated the Code in terms of section 8 (1) (a) to (d), section 8 (4) (b), section 2, section 3 (1) (a) and section 7 (1).

46. As a consequence of the 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 financial services provider in effecting the investments in Sharemax.

47. It stands to reason that the respondent caused the complainants loss.

48. I refer in this regard to the decision of the Board in the appeal of *J & G Financial Service Assurance Brokers (Pty) Ltd and another vs Robert Ludorf Prigge*[18]. Judge Harms stated that:

The next issue to consider is whether the non-compliance of a provision of the Code can give rise to legal liability, whether in contract or delict.

The liability of a provider to a client is usually based on a breach of contract. The contract requires of a provider to give advice with the appropriate degree of skill and care, i.e. not negligently. Failure to do so, i.e. giving negligent investment advice, gives rise to liability if the advice was accepted and acted upon, that it was bad advice, and that it caused loss. And in deciding what is reasonable the Court will have regard to the general level of skill and diligence possessed and exercised at the time by the members of the branch of the profession to which the practitioner belongs.

In the case of a provider under the Act more is required namely compliance with the provisions of the Code. Failure to comply with the code can be seen in two ways. The Code may be regarded as being impliedly part of the agreement between the provider and the client and its breach a breach of contract. The other approach is that failure of the statutory duty gives rise to delictual liability.

In both instances the breach must be the cause of the loss. We stress this point because the Ombud's reasons give the impression that any breach of the Code makes a provider liable for damages without due regard to this aspect of causation, namely did the failure to comply with the Code cause acceptance of the advice.

J. RECOMMENDATION

49. The FAIS Ombud recommends that the respondent pay the following amounts:

49.1 R120 000 to the first complainant

49.2 R400 000 to the second complainant

50. The respondents are invited to revert to this Office within TEN (10) working 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[19].

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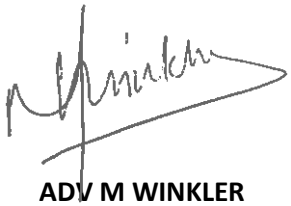
[18] Case no: FAB 8/2016, paragraphs 41 - 44

[19] "*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-*

51. The complainants upon full payment are to cede all their rights and title to the investments to the respondent.

Yours sincerely



ADV M WINKLER

ASSISTANT OMBUD

(a) the dismissal of the complaint; or
(b) the upholding of the complaint, wholly or partially….”