FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS-01901-12/13 FS 1
FAIS-01900-12/13 FS 1
FAIS-01417-12/13 FS 1

25 July 2017

MR AJ GOUWS
ABE GOUWS MAKELAARS CC

Per email: abgoubr@iafrica.com

Dear Mr Gouws

REMO EHLERS V ABE GOUWS MAKELAARS CC (first respondent) and ABRAHAM J GOUWS (second respondent). RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT (37 of 2002)

A. INTRODUCTION

1. Complainant, Mr Ehlers, had a longstanding relationship with the respondent during which complainant was introduced to investments in Pic Syndications (Pty) Ltd. (PIC). Over the years, and because of their relationship, complainant was persuaded by respondent to consider an investment in one of the property syndications promoted by Sharemax (Pty) Ltd. (Sharemax). Following the assurances by respondent that complainant could never go wrong with property, the complainant invested in Sharemax, specifically The Villa Retail Park Holdings Limited (The Villa).

2. It was only upon reading a newspaper article about Sharemax's financial problems that complainant felt the need to enquire from respondent about the security of his investment. Respondent assured complainant that the investment was sound, but the belief in this acclaimed soundness lasted only until complainant's monthly income stopped. Respondent stuck to his original statements that the investment was sound and that any failure to pay the monthly income was due to a temporary problem that would soon be resolved. The problem with the monthly income however, was not resolved. Complainant was later advised by respondent that he would receive his capital after ten

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years. Complainant interpreted this as a concession by the respondent that Sharemax was indeed in financial trouble.

B. THE PARTIES

3. The complainant is Mr Remo Ehlers, an adult male pensioner whose full particulars are on file with this Office.

4. The first respondent is Abe Gouws Brokers CC, a close corporation duly incorporated in terms of South African law, with registration number (1993/017920/23). The first respondent is an authorised financial services provider (FSP) (licence number 11991) with its principal place noted in the regulator's records as Negotium Building, c/o De Kaap en Buiten Streets, Welkom, 9459. The licence has been active since 23 December 2004.

5. The second respondent is Abraham Jacobus Gouws, an adult male, key individual and representative of the first respondent. The regulator's records confirm second respondent's address to be the same as that of the first respondent.

6. At all times material hereto, the second respondent rendered financial services to the complainant.

7. Respondent claims to have rendered financial services as a representative acting under the supervision of the now defunct Unlisted Securities South Africa[1] (USSA) trading as "FSP Network, (Pty) Ltd." as provided for in Section 13 of the FAIS Act.

8. The first respondent has since changed its name to "Advice at Platfin CC". I refer to the first and second respondents collectively as "the respondent". Where appropriate, I specify which respondent is being referred to.

[1] USSA was established by Gerhardus Rossouw Goosen while he was a director of Sharemax. Independent brokers like the respondent - who were licensed in their own right as FSPs but lacked the correct licence type - were able to market and sell unsecured debentures as representatives of FSP Network Ltd, trading at the time as "USSA". USSA was finally liquidated in 2013.

Delays in finalising this complaint

9. Sometime in September 2011, after the Office had issued the Barnes determination[2], respondent in that matter brought an urgent application to set aside the determination[3]. Before the fate of the application could be known, respondents sought an undertaking from this Office that it would not proceed to determine any other property syndication related complaints involving them.

10. Since no legal basis existed for respondent's demands, the Office proceeded to determine further property related complaints, involving the respondents. In response, respondents launched an urgent application for an interdict to stop the Office from filing the determinations in court, until the main application had been disposed of. The decision in the main application was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[4].

11. Following the decision of the High Court, which essentially dismissed respondent's application, the Office continued to determine complaints involving property syndications. However, in 2013 following the Siegrist and Bekker determinations[5] 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 it was a 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[6], after which the Office resumed (with due regard to the decision) processing complaints involving property syndications. As many as 2000 (mainly property syndication related) complaints had to be shelved pending the decision of the Appeals Board.

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

3 Respondent claimed that section 27 of the FAIS Act was unconstitutional

4 Gauteng High Court Division, case number 50027/2014

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.

C. THE COMPLAINT

12. Complainant knew respondent since 2005 when respondent first advised complainant about an investment in Picvest, otherwise known as "PIC"[7]. Complainant had been assisted by respondent to invest in PIC on three separate occasions between 2005 and June 2009. The PIC investments, however, are not relevant to the complaint being considered in this recommendation.

13. During July 2009, complainant sought investment advice from respondent in order to invest an amount of R95 000. The funds were a combination of the complainant's savings, inheritance and a portion of complainant's pension fund proceeds. The funds at the time were kept in a money market account. Complainant was looking for an investment that would yield a higher monthly income while his capital was kept intact.

14. Respondent recommended that complainant invest in Sharemax, The Villa[8] because it was, according to him, a safe investment. The agreement was subsequently concluded on 16 July 2009 for a period of five years, after which complainant's capital would be repaid. The agreement was that complainant would receive interest calculated on the capital sum at the rate of 12.5% per annum for the pre-occupation period, after which interest would decrease to 11% from date of occupation. In terms of the agreement, complainant would receive capital growth of 4% per annum and was set to increase to 9% for the remaining two years.

15. Complainant confirmed that respondent provided him with a prospectus and relevant documentation to sign; however, at no time was the content of the documents or the prospectus explained to him.

16. During August to December 2009, the complainant made two further investments in The Villa[9], in the amounts of R25 000 and R300 000 respectively. These two additional investments brought the complainant's total investment in The Villa to R420 000.

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7 PICVEST Investments (Pty) Ltd (PIC) then was an authorised FSP with licence number 20878. PIC marketed public property syndication investments until 2013 when its licences was withdrawn by the regulator.

8 Prospectus 9

9 Prospectuses 10 and 15

17. In 2010, complainant came across negative media coverage about Sharemax which included, *inter alia*, information that Sharemax had contravened the Banks Act. Upon referring to respondent, complainant was assured that his investment was safe. Even when complainant discovered his usual monthly interest payments were not paid in September 2010, respondent assured him that the problem was a temporary one and would soon be resolved.

18. Despite various attempts to resolve the matter, complainant was finally informed by respondent in April 2012 that his investments would be paid to him only after 10 years. Since September 2010, the complainant has not received a single cent and considers his capital lost.

D. RESPONDENT'S VERSION

19. In compliance with Rule 6(b) of the Rules on Proceedings of the Office of the Ombud, the Office referred the complaint to respondent on 4 July 2012, advising respondent to resolve same with his client. No response was received.

20. On 12 June 2015, the FAIS Ombud sent a notice to respondent in terms of Section 27 (4)[10] of the FAIS Act, informing him that the complaint had not been resolved and that the Office intended to proceed with an investigation. The letter invited respondent to deal with the question of appropriateness of his advice. Respondent was advised, *inter alia*, that he could be held liable in the event the complaints were upheld.

E. INVESTIGATION

21. Respondent replied on 27 June 2015 with supporting documentation for all three complaints. Below is a summary of his response:

    21.1 In response to the question as to how respondent expected the income to be paid, other than from investors' funds, respondent indicated that he was informed during his training sessions with Sharemax that income would be paid by the developer, Capicol, in the form of interest, as if it was financed by a bank.

[10] There were three notices in respect of the three investments. Essentially, the notices are the same save for the amounts. The letters and the notice are dealt with in this determination as one letter and notice.

21.2 As far as the risk in relation to the investments was concerned, respondent considered the investments as safe, as he had visited the building site and had seen with his *own eyes the concrete, bricks and steel used in the construction of The Villa.* It was respondent's submission that investments in property had always been safe. Respondent further noted that The Villa was not a high-risk investment, but became perceived as one because of the negative publicity.

21.3 In responding to the question of whether he had appropriately apprised his client of the risk involved, respondent stated that complainant had been provided with prospectuses[11] containing all the necessary details – including the risks involved. By virtue of this statement, this Office accepts that respondent himself had read and understood the prospectuses.

I shall demonstrate shortly that the respondent had certainly misconstrued the prospectus with his claims that the investment was safe and not high-risk.

21.4 Respondent further stated that in order to determine suitability of the product he took into account complainant's circumstances. These included the fact that complainant had been his longstanding client, had invested in PIC before, and that Sharemax paid a better monthly income than the bank's money market account.

F. ANALYSIS AND RECOMMENDATION

22. It cannot be disputed that the parties had an agreement that respondent would render financial services to complainant. That advice, without a doubt, had to meet the standard prescribed in the FAIS Act and the General Code, such that failure to abide by the FAIS Act and the Code, on the part of respondent, would amount to a breach of his contractual duties.

23. Section 2, part II of the General Code of the Conduct (the Code) states that a provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.

24. Section 8 (1) (a) to (c) of the General Code states that:

[11] The prospectuses referred to include The Villa 9, The Villa 10 and The Villa 15

"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…"

25. Section 9 of the Code requires a provider to maintain a record of the advice which record must reflect the basis on which the advice was given, and in particular:

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

(b) the financial products which were considered;

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

26. The questions posed in the notices in terms of section 27 (4) sent by this office to respondent had their answers grounded in the prospectus, such that, if respondent had read it, he would have understood that the investments were not suitable for complainant who sought a safe investment to protect his capital. I refer in this regard to the attached annexures A1, A2, and A3 being summaries of the The Villa Ltd prospectus, the Sale of Business Agreement, and Government Notice 459, (Notice 459) as published in Government Gazette 28690 that should be read together with this recommendation.

The Villa Ltd

Violations of Notice 459

27. From the onset, paragraphs 3.2 and 3.1.1 of the prospectus made it clear that the directors of Sharemax, who also were directors of all the other Sharemax companies involved in the prospectus, had intentions to violate Notice 459.

28. In this regard, the prospectus made provision for disbursing investors' funds to pay for the entire shareholding of The Villa Retail Shopping Investments (Pty) Ltd (The Villa (Pty) Ltd) from Sharemax. There is no detail as to how this benefited investors[12]. A subsection of provision 4.3 in the prospectus discloses that investor funds will be paid out to the sellers of the immovable property long before the transfer of the immovable property into the name of the syndication vehicle.

29. The movement of the funds was illegal and a direct affront to the very legislation that was meant to protect investors. I conclude that respondent must have been oblivious to the risk and could not have appropriately advised complainant in that case.

Conflict of interest

30. The prospectus does not hide the universal role of the promoter, highlighting that the 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. Respondent seems to have overlooked this fact.

Conflicting provisions of the prospectus

31. I refer also to the conflicting provisions of the prospectus (see paragraphs 19.10 and 4.3). First, paragraph 19.10 states that funds collected from investors would remain in the trust account and from the interest accumulated, investors would be paid their return. Paragraph 4.3 on the other hand conveys 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. The aforesaid is confirmed in the forms that complainant had completed to make the investment. This payment too, was in violation of the Notice.

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

[12] See paragraph 4.3 of the prospectus: Note: although the complainant would have invested through different prospectuses, the essence of the prospectuses pertaining to The Villa Ltd investment is the same.

32.1 Interest payable by the bank on investments made in line with section 78 (2A) at the time did not go beyond one digit. In fact, this office obtained information that the interest payable at the time was between 6.4% - 8.25%[13].

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

33. 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 (annexure A3). Two types of payments are dealt with in the SBA. These are payments to the developer, and agent Brandberg Konsultante (Pty) Ltd. (Brandberg).

Payments to Capicol

34. According to the agreement, investors' funds were moved from The Villa to The Villa (Pty) Ltd and advanced to the developer of the shopping mall. At the time of releasing the prospectus of The Villa, Sharemax had already advanced substantial amounts to the developer in line with this agreement[14]. A brief analysis of the business agreement reveals:

34.1 No security existed for the loan, which is clear from reading the prospectus and the agreement.

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

34.3 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.

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

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13 http://www.fidfund.co.za/banking-options/credit-interest-rate-history/ accessed on 20 July 2017.

14 Paragraph 4.23 of The Villa prospectus

34.5 The agreement is devoid of detail relating to the assessment of the developer's credit worthiness.

34.6 No detail is provided to demonstrate that the directors of The Villa had any concerns about the Notice 459 violations.

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

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

35. 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.

Payments to Brandberg

36. 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 how these payments benefited investors. No valid business case is made as to why commission had to be advanced despite the risk to investors. There was also no security provided against this advance to protect the investors' interests.

G. FINDINGS

37. Respondent was invited to provide his records of advice to demonstrate just why this investment was considered appropriate, taking into account complainant's circumstances. Apart from referring to the prospectus and a copy of the record of advice (which does not speak to complainant's personal circumstances) respondent failed to cogently respond to the questions.

38. It is worth noting that complainant had informed respondent that he could not afford to lose these funds as they represented his pension. Complainant's financial circumstances objectively indicated that he did not have the capacity to absorb high risk. Complainant was employed with Standard Bank

as an accounting clerk for approximately 25 years. Thereafter he joined Pick & Pay as a reception manager for 10 years before he retired. Complainant's highest qualification is grade 11.

39. This is exactly what the Code in section 8 (1) (a) to (c) enjoins providers to consider prior to providing advice. Apart from the claims that complainant required an increased income, there appears to have been no consideration of complainant's circumstances at all.

40. There is no indication that respondent considered any other products to address complainant's income needs. It appears that respondent simply compared the return from the bank money market account to that paid by Sharemax. This comparison alone is misleading as financial products cannot be compared only on the basis of returns. Such an act would have led complainant to believe that what he was contracting to, was akin to a bank product, which was simply not the case. In any event, had complainant insisted on high income after a proper discussion of the risks involved in this product, respondent had a duty to comply with section 8 (4) (b) of the Code[15].

41. The investment, no doubt, carried with it serious financial red flags that were apparent from the onset, and should have led a reasonable person in the position of respondent, to foresee that harm could result and take steps accordingly to mitigate it.

42. Respondent had to observe the provisions of sections 8 (1) (a) to (c) when he made recommendations to complainant. There is absolutely no evidence that respondent had appreciation for the risk involved in these Sharemax investments, which leaves this Office to conclude that the advice was inappropriate and a breach of respondent's contractual duties towards complainant.

43. On the basis of the reasoning set out in this recommendation, the risks in the investments were not disclosed, in violation of 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".

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[15] *"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".*

44. Respondent violated the Code in terms of section 2, 8 (1) (a) to (c), 8 (4) (b) and section 9.

45. Respondent must have known that complainant would rely on his advice as a professional financial provider in effecting the investment in Sharemax.

46. By virtue of respondent's inability to understand the risk inherent in these investments, the representations made to complainant were incorrect and in violation of section 3 (1) (a) (vii) of the Code[16]. There is no doubt that had the complainant been made aware of the risks involved in these investments, he would not have invested in Sharemax.

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

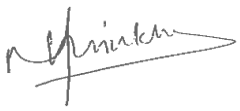
H. RECOMMENDATION

48. The FAIS Ombud recommends that respondents pay complainant's loss in the amount of R420 000.

49. Respondents are invited to revert to this Office within TEN (10) days with their 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) of the FAIS Act.

50. Interest at the rate of 10.5 % shall be calculated from a date SEVEN (7) days from date of this recommendation.

Yours sincerely



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ADV M WINKLER
ASSISTANT OMBUD

[16] *"must, as regards all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein and payable to the product supplier or the provider, be reflected in specific monetary terms: Provided that where any such amount, sum, value, charge, fee, remuneration or monetary obligation is not reasonably pre-determinable, its basis of calculation must be adequately described;.."*