FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS 07292/11-12/ KZN 1

2 August 2017

ATTENTION: Mr Anesh Maharaj

Nu-Era Insurance Brokers

Per email: anesh@nu-era.co.za

aneshnuerabackup@gmail.com

Dear Mr Maharaj,

HASSAN ALLY FAKHROODIN TYEBALLY & HASSAN ALLY RABIAH BIBI vs MAK INVESTMENTS AND ASSURANCE t/a NU ERA INSURANCE BROKERS & ANESH MAHARAJ. RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT, (ACT 37 of 2002)

A. INTRODUCTION

1. The complainants, Mr Hassan Ally Fakhroodin Tyebally, and his wife Hassan Ally Rabiah Bibi are pensioners from KZN. Their details are on file with the Office. On 30 May 2012, the complainants filed a complaint with this Office against Nu-Era Insurance Brokers and one of its key individuals, Anesh Maharaj. Complainants claim they established that something was wrong with the advice when their income from the Sharemax investment suddenly stopped during August 2010. They complained to respondents in September 2010. Their complaint was not resolved and so complainants filed their complaint with this Office on 30 May 2012.

Delays in finalizing this complaint

2. I find it important to address the delay in finalising this complaint. Sometime in September 2011, after the Office had issued the Barnes determination[1], the respondent in that matter brought an

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

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urgent application to set aside the determination[2]. Before the fate of the application could be known, respondents sought an undertaking from this Office that it would not determine any other property syndication related complaints involving them.

3. Since respondents had not provided any legal basis for their demands, the Office proceeded to determine further property related complaints involving respondents. In turn, respondents launched an urgent application for an interdict to stop the Office from filing the determinations in court, as well as issuing further determinations regarding property syndication related complaints. The decision was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[3].

4. In the wake of the pronouncement by the Court, the Office continued to determine complaints involving property syndications. However, in 2013 following the Siegrist and Bekker determinations[4] and the subsequent appeal, a decision was taken by the Office to halt processing property syndication related complaints. The decision was not taken lightly, but was a necessary risk management step. In the two determinations, 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 on 10 April 2015, after which the Office resumed processing complaints involving property syndications, paying due regard to the decision of the Appeal Board. As many as 2000 had to be shelved pending the decision of the Appeals Board.

B. RESPONDENTS

5. The first respondent is Mak Investments and Assurance Brokers CC, a close corporation duly incorporated in terms of South African laws, with its principal place of business at 103 Shannon Drive, Reservoir Hills, Durban. The first respondent is authorised as a financial services provider (FSP) with licence number 10036. The licence was issued on 15 June 2005 and is still valid. Nu-Era Insurance

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

3 Gauteng High Court Division, case number 50027/2014

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

Brokers appears to be the trade name of the first respondent. The respondents themselves use stationery-styled Nu-Era.

6. The second respondent is Anesh Maharaj, an adult male representative of the first respondent whose address is the same as that of the first respondent. The second respondent is noted in the regulator's records as one of the key individuals of the first respondent. Both respondents are collectively referred to in this recommendation as respondent.

C. THE COMPLAINT

7. Sometime during August 2009, the complainants consulted respondents for advice on investing their savings and pensions. They had both accumulated an amount of R794 000. They sought advice from respondent on how best to invest the funds to achieve capital growth and income. They were advised to invest R600 000[5] into The Villa, R100 000 with Old Mutual Life Assurance Company South Africa, (OMLACSA), and R94 000 into Kruger rands. The Villa was a public property syndications scheme promoted by Sharemax Investments (Pty) Ltd, (Sharemax). Both The Villa and OMLACSA investments were meant to endure for five years.

8. Both parties' versions confirm that The Villa investment was meant to generate a return of 12.5% by way of interest which would be paid monthly. The interest was said to be guaranteed until March 2011. The rate would then drop to 11% and was guaranteed until February 2012. The income thereafter would be based on the rentals collected from the property and was meant to escalate accordingly. Capital growth was estimated at 17.5% after five years, which the respondent estimated to be R105 000.

9. In their discovery that there was something wrong with the Sharemax investment, the complainants claim they discovered that the advice pertaining to the OMLACSA product was also flawed because it allowed them one loan. Complainants claim they were not informed of this restriction. Stranded, with no income and no alternative means to survive, complainants decided to seek a loan of about 80% from the OMLACSA investment. They claim that they lost the opportunity for generating growth from

[5] Each spouse had R300 000 invested in their own name.

this investment and blame respondent's advice. Complainants however, did not state what relief they seek in respect of this investment.

10. Complainants claim that the respondents failed to appropriately advise them. They state that right from the start, even though they sought an investment with a certain yield, they had informed the respondents that they required a product that secured their capital. They informed the respondents that the retirement savings was all they had to look after themselves throughout their retirement lives. They believed at all times that their capital and income from the investment were guaranteed. Respondents' own risk profiling confirm that complainants were rated as moderate investors.

11. Complainants blame respondent for the loss of their capital in Sharemax and seek relief in the amount of R600 000 from respondent.

D. RESPONDENT'S VERSION

12. The salient features of respondent's response appear in the paragraphs immediately here below:

12.1 In their first response, respondents provided lengthy detail of their due diligence, followed by details of how they went about recommending the investment to complainants.

12.2 As part of their due diligence, respondents had attended presentations dealing with Sharemax and received assurances from one Mr. Anton Swanepoel, whom they say has a master's degree in the FAIS Act. This individual, according to respondents, confirmed that no company was more compliant than Sharemax.

12.3 Aside from visiting some of the Sharemax shopping malls, the respondents made unsubstantiated claims about Sharemax being compliant with a Government Gazette published by the Department of Trade and Industry, which outlines requirements for property syndication schemes.

12.4 Although both clients came out as moderate risk in terms of their risk profile, they were prepared to take on more risk. According the respondents, property syndication investments may be regarded as high risk but they countered this by pointing to the shopping mall that

they maintained would have provided security for this investment. This claim by respondents that the mall provided security, flies in the face of the risk evidenced by the prospectus and, more so, by the warnings that are apparent in the front pages. Complainants needed to know that they had no security whatsoever for their investment.

12.5 The prospectus was given to the clients.

12.6 Complainants were aware of the guaranteed plan but they chose the income plan. (I have noted from both records of advice[6] that the respondent wrote that there are no capital guarantees and that only income is guaranteed.) The fact that respondents, having had access to their clients' financial details, and in the face of their own risk assessment which they maintained confirmed complainants' capacity for risk, chose to invest complainants' life savings in this investment, points to a violation of the law[7]. It is also disconcerting that respondents saw guarantees in this investment despite what is stated in the prospectuses. It is plain from the prospectuses that the income payable was subject to the discretion of the directors.

12.7 They claim that the complainants have not lost any capital and the complaint is premature. What is not disputed by the respondents is the fact that the investments were made for five years and the income was meant to be paid as agreed. As already stated, the investment stopped paying income in 2010 and neither has the capital been repaid.

12.8 The respondents contend that the abrupt ending of the complainants' income was due to a regulatory risk caused by the decision taken by the Reserve Bank (SARB) in respect of debentures issued by Sharemax-promoted companies. This regulatory risk, according to respondents, resulted in Sharemax having to stop paying interest.

Respondents' Supplementary Responses

13. In summary, the respondent's state in their supplementary response that:

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6 Each client had their own record of advice.

7 Section 8 (1) (a) to (c) of the Code

13.1 They (as respondents) had been misled by Sharemax and the Financial Services Board (FSB). The level of deception was not evident at the time and the information was not provided to the respondents.

13.2 Referring to an article of October 2012, the respondents state that Mr Gerry Anderson, the then Deputy Executive of the FSB, had stated in March 2007 that he was very pleased with the compliance of the Sharemax group. Respondents state: the fact that '*individuals in [sic] the capacity of Mr Gerry Anderson could endorse and promote the Sharemax group gives us food for thought*.'

13.3 The directors and managing director of the Sharemax group of companies had misled the public.

13.4 The respondents state there was a massive scale of fraud, dating back to 2008, when the inspectors of SARB failed to inform the FSB of certain wrongdoings. SARB took three years to realise that Sharemax had contravened the Banks Act. In the interim the FSB had renewed Sharemax's FSP license twice.

E. INVESTIGATION

14. During June 2015, this Office sent a notice to the respondents in terms of section 27 (4) of the FAIS Act, (the Notice) informing respondents that the complaint in this matter had not been resolved and that the Office had intentions to investigate the matter. The letter reads (omitting for now words not material to the essence):

14.1 The prospectuses of both the Villa Retail Park Holdings and 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.

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

14.2 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.

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?

14.3 Were your clients properly apprised of these risks? Please provide evidence to this effect.

14.4 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.

F. ANALYSIS AND RECOMMENDATION

15. There appears to be no new facts from respondents' response to the Notice sent to them in 2015.

16. On 7 November 2016, a Mr Deon Pienaar filed an application for review, purportedly acting on behalf of the respondents. Even though the Office informed Mr Pienaar that his review papers were not useful in assisting the Office resolve this complaint, he persists in his application.

17. There is no question that the parties had an agreement that respondent would render financial advice to complainants. That advice, without a doubt, had to meet the standard prescribed in the FAIS Act and the General Code. The complaint therefore, is not premature.

18. 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.

19. 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…"

20. Section 8 (4) (b) states that: "Where a client-

(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 need, objectives and circumstances".

21. The recommendation to invest in The Villa was in violation of section 8 (1) (c). In this regard, respondents cannot explain what made them undermine the result of their own risk analysis by placing complainants' funds in the high risk Sharemax investment. The respondents knew that the complainants only had their savings which they could not afford to gamble. To demonstrate that the risk was not explained properly, respondents wrote in their records of advice that only the income was guaranteed but not the capital. In their response to the Rule 6 (b) Notice to this Office, they claimed that the complainants' capital would have been secured by the 'massive' shopping malls; this makes it evident that respondents could not have understood the risk in the investment at all. In short, not only did complainants not accept the high risk involved in this investment, they were simply not appropriately advised. I refer to the attached annexures, being summaries of The Villa Ltd prospectus and Government Notice 459, (Notice 459) as published in Government Gazette 28690. I show with these summaries that there was sufficient information (right from the start) for respondent to have steered clear of these investments as investors would have no protection whatsoever.

The Villa Ltd

Violations of Notice 459

22. 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.

23. 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 of the concomitant benefit for investors and neither is the full purchase price noted anywhere in the prospectus.

24. 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.

25. 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 conclude that respondent must have been oblivious to the risk and could not have appropriately advised complainants in that case.

Conflict of interest

26. The prospectus does not hide the ubiquitous role of the promoter. Note that there is no evidence that there was ever an independent board of directors, nor is there evidence that there ever were independent audit, risk and remuneration committees in the entire group of Sharemax. It is fair to conclude that right from the start, investors would have no protection whatsoever as the directors would only be accountable to themselves. In simple terms, the investors were at the mercy of the directors. This too, does not appear to have attracted respondent's eye.

Conflicting provisions of the prospectus

27. I refer also to the conflicting provisions of 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 as at first, 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 too was in violation of the Notice 459.

28. There are two problems with the proposition that the investors' return was paid from the interest generated by the trust account. They are:

    28.1 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%[8].

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

29. The prospectus states that the interest payable on the claim component of the unit will be determined from time to time by the directors[9].

Sale of Business Agreement (SBA)

30. 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, payments to an agent, Brandberg Konsultante (Pty) Ltd. (Brandberg).

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8 http://www.fidfund.co.za/banking-options/credit-interest-rate-history/

9 See paragraph 9.3.1

Payments to Capicol

31. 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:

    31.1 No security existed for the loan in order to protect investors, which is clear from reading the prospectus and the agreement.

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

    31.3 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.

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

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

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

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

    31.8 The conclusion is ineluctable that the interest paid to investors was from their own capital.

32. 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

33. 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.

34. It is plain from the response of the respondents that this risk was not properly disclosed. On the respondent's own version, they saw the shopping malls as security for complainants' capital. They could not have appropriately advised complainants in that case.

G. THE LOSS

35. On the basis of the reasoning set out in this recommendation, the risk involved in the product was extremely high and inappropriate for complainants' risk capacity. Respondents simply did not understand the risk at all and this is clear from their versions. Respondents must have known that complainants were completely reliant on their advice. I have perused all their supporting documents and conclude that respondents violated sections 2, 3 (1) (a) (vii), 7, and 8 (1) (c) and 8 (2) of the Code, which amounts to a material breach of contract. I may add that in the event complainants persisted in a return which warranted high risk, respondent was at liberty to invoke section 8 (4) (b). There is no evidence that respondents complied with this section.

36. The loss experienced by complainants flows directly from the consequences of failure by the respondents to observe the Code in rendering financial services. In this regard two issues come to mind. First, respondents should have never marketed an investment they do not understand. It is clear that they did not know how to assess this investment. Second, respondents could not see that several paragraphs of the prospectus were in conflict with Notice 459. From the time the money was paid into the trust account of the attorneys, it was lost almost immediately thereafter due to the illegal payments, and this was not hidden from respondents. The prospectuses were clear. Notwithstanding several invitations, respondent still failed to explain how the investors' income was paid. Even Mr Pienaar's papers which were filed on behalf of respondents fail to deal with this

particular issue. These were critical pointers of risk which respondents either ignored or were oblivious to.

37. There is no doubt that had the complainants been made aware of the risks involved in these investments, they would not have invested in Sharemax. On the facts of this case, the respondent's conduct caused complainants' loss.

H. RECOMMENDATION

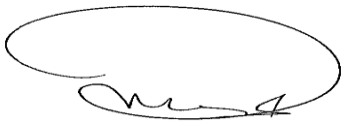
38. The FAIS Ombud recommends that the respondents pay the complainants the amount of R300 000 each to both complainants.

39. No recommendation is made in respect of the OMLACSA investment.

40. The respondents are invited to revert to this Office within TEN (10) working days from date hereof 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).

41. Interest at the rate of 10.25 % shall be calculated from a date TEN (10) days from date of this recommendation.

Yours sincerely



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