THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

CASE NUMBER: 06661/10-11/WC 1

In the matter between:-

Jacqueline Bekker	**Complainant**
and	
Edward A Carter – Smith	**1st Respondent**
Sharemax Investments (Pty) Ltd	**2nd Respondent**
FSP Network (Pty) Ltd	**3rd Respondent**
Gerhardus Rossouw Goosen	**4th Respondent**
Johannes Willem Botha	**5th Respondent**
Dominique Haese	**6th Respondent**
Andre Daniel Brand	**7th Respondent**

DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT NO. 37 OF 2002 ('FAIS ACT')

A. THE PARTIES

[1] The complainant is Jacqueline Bekker, a female pensioner who resides at 30 Eksteen Street, Heidelberg, Western Cape.

[2] First Respondent is Edward A Carter – Smith, a licensed financial services provider (FSP) of unit 103, Hole in the Wall, Main Road, Somerset West, Western Cape. His FSB number is 13757.

[3] Second respondent is Sharemax Investments (Pty) Ltd ("Sharemax"), a company registered in accordance with the laws of South Africa with registration number 1998/019038/07. Sharemax was at all times material hereto, a licensed Financial Services Provider (FSP No: 6153) and its registered address is 105 Club Avenue, Waterkloof Ridge, Pretoria. Its license however, lapsed sometime in October 2012 according to the FSB's website. Sharemax is the product provider and promoter of the investments in question. Sharemax is currently under business rescue.

[4] Third respondent is FSP Network (Pty) Ltd t/a Unlisted Securities South Africa ("USSA"), a company registered in accordance with the laws of South Africa with registration number 2002/021751/07. USSA was at all times material hereto, a licensed Financial Services Provider (FSP nr: 6152) and its registered address is 993 Swaartbaars Street, Garsfontein. Their license however, lapsed sometime in October 2012. USSA is currently under liquidation.

[5] Fourth respondent is Mr Gerhardus Rossouw Goosen ("Goosen"), an adult male and Director of Sharemax and USSA. Goosen is joined in this matter as a Director and compliance officer of Sharemax and USSA and the Key Individual of the latter. He resides at 18B Vlakvoëltjie Street, Rooihuiskraal.

[6] Fifth respondent is Mr Johannes Willem Botha ("Botha"), an adult male and Director of Sharemax. Botha is joined in this matter as a Director of Sharemax. He resides at 36 Glendower, Woodhill Estate, Pretoria.

[7] Sixth respondent is Ms Dominique Haese (“Haese”), an adult female and Director of Sharemax. Haese is joined in this matter as a Director, Key Individual and representative of Sharemax. She resides at 10 Oxford Street, Lynnwood, Pretoria.

[8] Seventh respondent is Andre Daniel Brand (“Brand”) an adult male and director of Sharemax. Mr Brand is joined in this matter as a Director of the second respondent. He resides at 150 Langenhoven Street, Constantia Park, Pretoria.

[9] The fourth to seventh respondents are also interested parties as they are directors of Sharemax Zambezi Retail Park Investments (Pty) Ltd (“Zambezi Investments”) and Sharemax Zambezi Retail Park Holdings Ltd (“Zambezi Holdings”).

B. THE COMPLAINT

[10] The complainant is a 73 year old pensioner. She recently underwent bypass surgery; she suffers from high blood pressure and diabetes. Her husband is 71 years old and he too is retired. His health is poor and he can no longer work. Both the complainant and her husband worked until retirement age and planned to live off their savings.

[11] The complainant and her husband used the services of the first respondent over a period of time and were generally satisfied with his services. The trouble began in April 2008 when the complainant invested an amount of

R190 000 – 00 in a product promoted by Sharemax Investments (Pty) Ltd, namely a property syndication being Sharemax Zambezi Retail Park Holdings Limited. In November 2008 the complainant made an investment of R300 000 – 00 into the same product. The said investments were made following the advice of the first respondent.

[12] The first respondent was familiar with the complainant and her husband having dealt with their finances previously. According to the complainant, the first respondent knew that the complainant was a pensioner who had absolutely no appetite for risk. The complainant specifically informed the first respondent that she is a conservative investor and that she did not “want to put all her eggs in one basket”.

[13] The complainant points out that the first respondent repeatedly assured her that the Sharemax investment “was safe”. First respondent repeatedly informed the complainant that the risk in Sharemax was as much a risk as the banks in this country collapsing.

[14] Complainant states that she relied on the expert advice of the first respondent and invested all the available funds that she had. She now believes that the first respondent did not give her good advice and that he was induced by the attraction of lucrative commission to advise her to make this investment.

[15] Complainant is particularly upset about the second investment of R300 000 – 00. According to the complainant the first respondent called her and offered her an opportunity to make money on a short term investment that can

possibly pay an increase of 40% on her capital. The first respondent explained that the Zambezi Shopping Mall was sold and that an immediate investment in Zambezi will net her a return of 40% on the capital.

[16] Complainant expressed concern over the safety of this investment, first respondent assured her that the investment was safe and represented an opportunity not to be missed. First respondent assured her that the investment was for six months only as he had satisfied himself that the Zambezi had been sold. First respondent even mentioned that the complainant was “lucky” to be made this offer as the investment was already fully subscribed. First respondent mentioned that the complainant was receiving special treatment as a result of having made the first investment in Zambezi.

[17] Complainant made the investment as a short term investment that will provide her with a good return on her capital. Again the investment was made on first respondent’s assurance that the investment was safe. He told the complainant that he personally travelled to Pretoria to view the project and saw an offer to purchase. According to complainant the first respondent assured her as follows:

“It is as safe as putting your money in one of the main banks operating in South Africa, the chances of Sharemax Zambezi failing are the same as the chances of ***all*** *the banks in South Africa failing.”*

[18] A factor which upset the complainant is that at a point, first respondent began having doubts about the sale of Zambezi and began writing to the directors of Sharemax questioning the investment. However first respondent did not

divulge his reservations to his clients and kept selling the investment. This is what the complainant said about this in a letter to the first respondent:

"From your enclosed copies of correspondence with yourself and Sharemax, you were already worrying about their dealings in April 2009, and yet as late as September 2009 you were still selling their shares to your clients. I here do question your integrity. I end up with a feeling that commission became more important to you than the safety of your clients capital".

[19] In her complaint, the complainant questions the competence of the advice given by the first respondent and believes that he did not carry out his duties as a professional planner. In particular she questions the advice bearing in mind the inherent risk in the investment and her own tolerance for risk. She even points out that when she was advised to invest she signed a form which required her to indicate the risk factor that she can tolerate on a scale of 1 to 10. The complainant chose 1 as *"being the lowest risk".*

[20] In her complaint to this office, the complainant had this to say. I include it as it is of particular significance:

"I had to make an instant decision because Mr. Carter-Smith said that it was only as a favour to him that the second amount invested by me would be accepted by Sharemax, as it was already fully subscribed.

As, according to the prospectus of Sharemax Zambezi, the money would be held in trust by lawyers until such time as the building was completed and taken transfer of by Sharemax Zambezi, theoretically the money should have been safe. It appears that this money, which should have been earning

interest while it was in the lawyers trust account, was illegally handed over to the builders without the aforementioned transfer taking place."

[21] Complainant seriously challenges the integrity of the first respondent. She has in her possession a letter, dated 8 May 2009, written by first respondent to a director of Sharemax, Dirk Koekemoer, in which the following is stated;
"I am now going to step forward and accuse you and your company of presenting misleading information which is tantamount to blatant lying. I suspect now that you must have done this deliberately to promote investment in Zambezi with false information."
Notwithstanding this correspondence, first respondent kept reassuring the complainant that all was well. Complainant finds this to be dishonest. To make matters worse, in spite of accusing Sharemax of giving misleading information, complainant points out that first respondent, towards the end of 2009, was still selling Sharemax products namely The Villa.

[22] After Sharemax stopped payments, first respondent wrote to complainant offering to pay her the shortfall in her and her husband's income in the amount of R1500 – 00 per month out of his own pocket. This payment remained an unfulfilled promise.

[23] The complainant further believes that there is no prospect that Sharemax will repay her capital and lost income. She refers to receiving correspondence from Frontier which merely refers to one scheme after another with no payment date in sight. She wants the first respondent to compensate her for

her loss. Complainant describes her situation as desperate due to having no income and no savings.

[24] Complainant concludes by stating that the first respondent cannot blame the directors of Sharemax as there was a professional duty on him to place her funds in an investment that was appropriate for her needs and tolerance for risk.

C. FIRST RESPONDENT'S RESPONSE

[25] The complaint was referred to the first respondent along with a notice in terms of section 27 (4) of the Act.

[26] It is significant that the first respondent forwarded a response directly to the complainant after the latter complained to the FSB. I wish to deal with the details of this first.

[27] The first respondent first gave the following explanation:

27.1 Sharemax stopped paying income to investors as a result of a complaint lodged with the Reserve Bank by Nedbank.

27.2 The complaint was that Sharemax was doing business as a bank in contravention of the Banks Act.

27.3 It was for this reason alone that Sharemax stopped paying investors.

27.4 The Reserve Bank ordered Sharemax to stop paying investors.

27.5 The media got hold of this and “announced doomsday upon Sharemax”.

27.6 This reporting caused panic amongst investors.

[28] The first respondent then makes comment about his role as an advisor to the complainant. He states that it was his duty to assess the complainants level of risk based on her age and her “investment horizon (time)”. He further points out that “I was also to ensure as a professional financial planner that you were not unduly exposed with all your eggs in one basket”. These are significant comments.

[29] The first respondent then deals with the consequences of the complainant’s complaint to the FSB, pointing out that if he is found guilty he will lose his license. First respondent then expresses the hope that the complainant will be persuaded to withdraw her complaint.

[30] Then follows a rather telling comment as follows “you as a consumer of financial products expect to be given advice and sold appropriate product by a person/planner/broker that shows integrity and also appropriate skill.” First respondent describes this as “quite onerous” as consumers often seek advice on short notice.

[31] First respondent mentions that in order to reduce “my risk of making mistakes” certain industry standards must be applied. They are:

31.1 “I must be registered with the FSB

31.2 Prove I am fit and proper

31.3 Have an education on my profession – proof of this needs to be lodged with the FSB

31.4 Market product that I am accredited to market

31.5 Only market product of institutions that are registered with the FSB

31.6 Offer advise based on my level of skill”

[32] The first respondent then concludes that he met these standards and therefore enjoys a “level of protection”.

[33] First respondent points out that he was a financial commentator on radio and has the “highest qualification available in my profession that of CFP™ (Certificate in Financial Planning).” He is registered with the FSB and financial planning institute. He states further that he has 25 years of service and he only deals with “institutions as stated by the FSB”.

[34] First respondent states that he has shown, as he must, that:

34.1 “By placing the investment you and I both declared a signed form stating that this was an appropriate investment for you and that you and Mr. Bekker did have other funds at the time

34.2 The risk profile was appropriate to your need and situation”

[35] First respondent then proceeds to explain why he decided that Sharemax was appropriate for his clients. He states that the prospectus was approved by

Standard Bank, Weavind and Weavind a 104 year old law firm, the DTI (Department of Trade and Industry) and the FSB gave Sharemax a license. He also flew to Pretoria to see the development and to “peruse” the offer to purchase.

[36] First respondent then makes a significant admission that the investment in Zambezi was driven by the “carrot” that “the supposed offer to purchase and that the building was already sold”. He states that this was the case for all his “clients involved”. He also expresses the view that “the whole scope of the financial environment was secure”. He then makes the point that he could not have known otherwise.

[37] First respondent concludes that he applied his skills diligently. He requested that the complainant withdraw her complaint with the FSB. He also recommends that the complainant should “assert her complaint” against Sharemax and its directors.

[38] The complainant rejected the first respondent’s explanation and request to withdraw the complaint and pursued a complaint to this office.

[39] On the 26th March 2011 the first respondent presented his written response to the complaint to this office. I now deal with this response. He initially sees complainant’s complaint as a plea for help rather than a complaint against him. He nevertheless treats it as a complaint in terms of the act.

[40] First respondent began his response by admitting that the complainant's investment was made as a result of his encouragement. First respondent concedes that complainant did not make the Zambezi investment as a decision of her own.

[41] Having made this admission first respondent set out the history of how this investment came about. He states that complainant had previously invested in PIC and had enjoyed success with this investment. Due to this experience complainant was willing to invest in Sharemax. The suggestion here is that the complainant was an experienced investor.

[42] First respondent continues in this vane and states that "Mrs. Bekker and I agreed that Sharemax was more suitable than PIC (Picvest)". The reasons being that Pic had changed its syndication offering and that Sharemax was offering a similar investment to the original Pic investment and was therefore more suitable.

[43] First respondent then refers to a letter that was circulated by the directors of Sharemax. This letter stated that a buyer had made an offer to purchase Zambezi and that investors can expect an income plus "40% on the sale of the development". First respondent states that he showed this letter to complainant and they "jointly agreed" that since they had successfully done this with PIC it would be a "wise decision" to invest in Sharemax.

[44] First respondent states that this was supported by the fact that Sharemax issued the prospectus according to the DTI (Department of Trade and

Industry) and that Sharemax was licensed by the FSB. He also points out that "the offer to purchase was declared legitimate on examination of the "otp" (Offer to purchase)." He does not say who made this declaration of legitimacy.

[45] First respondent then sets out certain financial information about the complainant and her husband. The purpose of which was to make the following points:

a) That "risk declarations" were made;
b) That complainant and her husband were possessed of emergency funds; and
c) That the funds invested in Sharemax did not represent the investor's entire capital.

[46] First respondent states that his license to sell unlisted shares "was held under USSA". Then follows an explanation of how he complained to the FSB and the DTI about the conduct of Sharemax. First respondent is of the view that the FSB licensed Sharemax and should provide restitution for the loss of investors.

[47] First respondent explains that he is a CFP™ and registered with the FPI (Financial Planning Institute). He has 25 years' experience and in respect of this investment he followed "strictly the GAPP code (generally accepted planning practices as laid down by the financial planning institute.)"

[48] First respondent concludes by expressing hope that the Reserve Bank will protect investors and that "this is a short term problem". He also states that he

spoke to all the “leading directors” dealing with Zambezi and opines that this “is a solvable case”.

[49] Attached to the first respondent’s response is an open letter that he wrote to his clients. This letter is significant as it sets out first respondent’s version as to how the complainant’s second investment in Zambezi was made. The letter begins by setting out the first respondent’s experience as a FSP (Financial Services Providers). He states that “with this experience and knowledge, I am able to exercise a reasonable level of skill on behalf of my clients in determining risk-return as well as future probabilities of selling these buildings at a reasonable return”.

[50] First respondent then refers to a letter circulated by the directors of Sharemax to all FSPs and consultants, signed by Willie Botha. This letter, dated 4 November 2008, encouraged investors to invest in Zambezi and promised a return, within one year, of 50%. A copy of this letter is in our file. I deem it necessary to quote from this letter:

“*An investor who makes an investment today (November 2008), receives 12% income interest for a year. The centre is sold to the new owner as soon as occupation takes place and the income drops to 10.0% per year.*

The centre was originally acquired by Sharemax for investors at a cap rate of 10.4% (that give a projected purchase price of R923 000 000) and is sold again at a cap rate of 7.5% (the projected sales price is then R1 280 000 000). This means that investors will receive capital growth of 38%, should the investors decide to accept the offer to purchase. If the 12% income from

interest is added, the investors actually receive a gross return of 50% in only one year!

Because no initial costs are recovered from Sharemax's investment products and there are also no costs for investors with the sale of a centre, the investors therefore receive the full 50% return, less a potential agent's commission of between 3% and 4%.

In the current unstable economic climate wherein the whole world currently finds itself, with investors who have already lost a large percentage of their investments, Sharemax still offers the best possible investment instrument for investors who would like to earn an above average return at a low risk.

This 50% return and an investor's money is only tied up for one year … it wants to be done!

React before it's too late."

[51] On first respondent's own version he found this "to be too good to be true". He therefore decided to check the investment himself. He states that he satisfied himself that Sharemax had indeed sold Zambezi as he saw the Offer to purchase; he saw the signature on the document and even contacted the agents.

[52] What is interesting is that the first respondent states that "a colleague and I had the Sharemax prospectus independently assessed". No details are given as to when this assessment was done nor does he tell who carried it out and what the result was.

[53] First respondent details how he travelled to Pretoria to carry out further investigations by visiting Sharemax offices and talking to the latter's officials. He then told his clients that this was a "good deal" because of the offer to purchase. He felt that clients "would only be in for one year with a great return, which was not unusual for property developments".

[54] First respondent then readily admits that he began encouraging his clients to invest in Zambezi. He makes the following interesting statement:
"It was quite a fight to secure your clients share of 'the deal', as the money just came tumbling in into their offices at 15 to 20 million a day to get into this wonderful opportunity, secure in the knowledge and assurance of the otp."

[55] When the promised return did not materialize, first respondent began corresponding with Sharemax to find out what was happening. First respondent received a variety of excuses from Sharemax. Thereafter first respondent concludes as follows:
"I have to conclude that Sharemax fraudulently misrepresented the facts so as to encourage investment into the Zambezi development".

[56] In his response to this office first respondent does not dispute that complainant made the investments in Zambezi as a result of his advice. He even admits that he encouraged complainant to make the second investment of R300 000 – 00 on short notice and with a promised return of 40% to 50% after one year. However he tries to justify his advice and takes no responsibility for the complainant's loss.

D. ANALYSIS

[57] At the outset I have to say something about the first respondent's qualifications. It is of note that he is a CFP™ and has 25 years of experience in the industry. On the first respondents own version he is highly qualified and understands his duties and obligations as a licensed FSP. From his correspondence it is clear that he has a thorough understanding of the Act and the Code. The point I make is that on the first respondent's own version, one can expect from him a very high standard of financial services. This is exactly what the complainant expected and put her trust in his competence. Thus when first respondent described Sharemax as a "safe" option, complainant accepted this.

[58] It is common cause that first respondent acted as the complainant's advisor for many years. He had a good understanding of her financial position and does not dispute that she was a conservative investor who had no tolerance for risk. First respondent suggests that complainant jointly decided, with him, that Sharemax was an appropriate investment. Complainant denies this and states that she was encouraged to invest in Sharemax by the first respondent.

[59] First respondent also tries to justify his advice by suggesting that the complainant had an appetite for property syndications as she had previously invested in PIC and had made a good return. The truth is that the investment in PIC was also made on first respondent's advice and was equally a risky investment.

[60] However the first respondent's conduct came under serious scrutiny when he advised complainant to invest R300 000 – 00, the last of her available funds, in Zambezi. First respondent does not deny that he encouraged complainant to invest. Nor, significantly, does he dispute his advice that this was a safe investment. First respondent does not dispute that his advice was based on the understanding that Zambezi had been sold and that investors could expect a return of up to 50% within a year.

[61] Here one has to call into question the first respondent's competence and ethical standards. He readily admits that this return appeared to be "too good to be true". As an experienced FSP and he must have realized that a return of 50% after one year is a ridiculously extravagant return and first respondent should have treaded cautiously. This wonderful return was being offered even to first time investors in Sharemax. Instead First respondent made a great show of having carried out due diligence before advising clients to invest. Even if he was satisfied that this was a viable proposition, the question to be answered is whether or not this was an investment that was appropriate for the complainant bearing in mind her tolerance for risk.

[62] Of concern to me is that first respondent, notwithstanding his claim to being highly competent, appears to have fallen for the Sharemax marketing strategy. He swallowed the promise of 50% return and "rushed" or "fought" to get his client a share of this wonderful deal. The only explanation for this is one or more or all of the following:

a) He was incompetent and failed to work out that this was a ridiculously good investment;
b) He was negligent and failed to apply his skills in the interests of his client;
c) He found the commission of 6%, with no claw back, too tempting.

[63] I am also gravely concerned that first respondent expressed certain reservations about Sharemax and at one point accused the latter's directors of disseminating misleading information. Yet he did not disclose these reservations to his clients and simply continued to market Sharemax products. The only reasonable inference to be drawn is that the commission became far too attractive and his clients' interests were of little or no concern. This is reckless conduct.

[64] The first respondent now complains that he was misled by the directors of Sharemax. He calls these directors liars. It is too late to blame the directors of Sharemax. If the first respondent merely applied the Act and Code and carried out his obligations as a licensed FSP, he would not have advised the complainant to invest in risky, too good to be true, property syndications.

[65] First respondent required the complainant to sign a disclosure document that was provided by Sharemax. This document makes it plain that this is an investment that represents a risk to capital and that income is not guaranteed. For a full discussion on this document see the determination in Siegrist, the full reference appears below.

E. LICENSING

[66] Although first respondent is a CFP™, he did not have a license to sell unlisted shares and debentures. He sold this investment as a section 13 representative of USSA. This means that he was advising the complainant under supervision of his principal, USSA. First respondent was under a duty to ensure that he understood this product to the point where he was competent to give responsible advice.

[67] For a full discussion on the application of section 13 of the Act with particular reference to USSA and its representatives, see the following determinations: GERALD EDWARD BLACK vs JOHN ALEXANDER MOORE and another, case number FAIS 01110/10-11/WC1 paragraphs 66 to 93. GERBRECHT ELIZABETH JOHANNA SIEGRIST VS CORNELIUS JOHANNES BOTHA T/A C J BOTHA FINANSIËLE DIENSTE AND OTHERS CASE NUMBER FAIS 00039/11-12/GP 1.

Copies are available on this office's website, www.faisombud.co.za.

F. FINDINGS

[68] On the facts before me, the first respondent failed to comply with the most basic provisions of the Code. In particular:

68.1 he failed to apply his mind to the fact that the complainant was a pensioner and by all objective accounts was not an investor who could tolerate any risk;

68.2 he ignored the outcome of his own risk assessment and needs analysis which clearly informed the first respondent that the complainant wanted her capital to be guaranteed, with some growth, and an income of between 10% and 12%. The first respondent knew that the Sharemax investment was entirely inappropriate for the complainant;

68.3 he failed to question how Sharemax could possibly offer a return of up to 50% on capital after only one year;

68.4 he was dazzled by the lucrative commissions to the point where he failed to follow his own instincts that told him that this was too good to be true;

68.5 he failed to offer complainant other or alternative products and quotes, this is common cause; and

68.6 he failed to properly manage the conflict of interests between himself, Sharemax, USSA and his client.

[69] The first respondent contravened the provisions of section 2 of the Code; which provides :

"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."

[70] First respondent, under the supervision of USSA, further contravened the provisions of section 3 (1) (a), (b) and (c) of the code as well as sections 4, 7

and 8. The first respondent together with his supervising principals contravened section 13 of the Act.

Investor protection

[71] It is a well-documented fact that investors have been losing billions of rands in failed investment schemes. These schemes range from Forex scams to property syndication. The question that must be asked is what kind of process and legislation is in place to provide the investors with some protection.

The legislative frame work

[72] The financial services industry, by its very nature, requires regulation and oversight. Absent this, investors will be vulnerable to financial predators bent on making unsuspecting investors part with their money. The industry is in fact highly regulated. This begs the question, where did it go wrong?

[73] For purposes of this determination, the following legislation is relevant:

73.1 The FAIS Act ;

73.2 Financial Services Board Act 37 of 2002;

73.3 The Companies Act 71 of 2008 and its predessor;

73.4 The Securities Services Act 36 of 2004;

73.5 Govt notice on property syndication;

73.6 Attorneys act

73.7 Auditors Professions Act 26 of 2005;

73.8 IRBA legislation

ACT Audit Solutions

[74] In the Siegrist determination, I wrote about the role of Sharemax's auditors, ACT Audit Solutions Inc. A letter was sent to the auditors wherein a number of important questions were addressed. At the time of finalizing the Siegrist determination, there was no response from this firm of auditors. On the 31st January 2013, a response was received from the auditor's attorneys. This response is significant and I intend to deal with it in some detail.

[75] It is worth repeating that auditors and attorneys are appointed for the principal purpose of investor protection.

[76] It is appropriate to repeat the contents of the letter written by this office, the relevant part is as follows:

"*9. As you are aware, the law places an obligation on the Auditors to report any suspicion of wrongdoing or possible breaches of the law. In that regard, we draw your attention to the provisions of the Auditing Professions Act 26 of 2005, and in particular section 45.*

10. In the premises, we require your response to the following questions:

(a) *Can you provide us with an explanation as to how the funds were transferred out of the attorneys trust account?*

(b) *Did you report any transgression of the law by Sharemax / The Villa or Zambezi, in this regard or in any other instance?*

(c) *Did you report any non-compliance with the law by the directors of Sharemax / The Villa or Zambezi, or the attorneys Weavind and Weavind?*

(d) *Did you establish the legal basis for the movement of the investors' money from the Attorneys Trust account?*

(e) *Can you give an account of what happened to the interest that was earned on the investors' funds held in trust in terms of section 78(2A) of the Attorneys Act?*

(f) *Can you provide us with an explanation as to how investors were paid interest of 12%, bearing in mind that both The Villa and Zambezi had no trading history?"*

[77] The response to this letter is worth quoting here in full. The letter is from the auditor's attorney and it reads as follows:

"1. We have consulted with Advoca Auditing Inc. (previously known as ACT Audit Solutions Inc and for purposes of this letter, referred to as "ACT"). The purpose of this letter is to respond to the enquiries raised in paragraph 10 of your letter dated 18 December 2012.

2. Ad paragraph 10 (a)

2.1 ACT was at no stage the auditors of the Weavind and Weavind trust account and does not have direct knowledge as to exactly how funds were transferred.

3. Ad paragraph 10 (b) to (d):

3.1 ACT sought legal opinion regarding the application of Notice 459 and was advised that Notice 459 is not applicable to The Villa and Zambesi schemes. A reportable irregularity with reference to contravention of Notice 459 was therefore not reported in terms of Section 45 of the Audit Professions Act as ACT did not have reason to believe that a reportable irregularity took place.

3.2 ACT also sought legal opinion regarding the validity of the transfer of funds to investment property companies in the Villa and Zambesi schemes prior to registration of transfer of the property to investment property companies having regard to the provisions of prospectuses.

3.3 ACT concluded after obtaining legal opinion that payment of funds prior to registration of transfer may constitute a reportable irregularity on a proper interpretation of prospectuses.

3.4 In terms of Section 45 of the Audit Professions Act, an auditor that is satisfied or has reason to believe that a reportable irregularity has taken place or is taking place, must report such reportable irregularity to the Regulatory Board. ACT had reason to believe that a reportable irregularity took place and reported the transfer of funds to the Regulatory Board.

3.5 ACT followed the process set out in Section 45. Sharemax's response was that no reportable irregularity took place as the prospectuses contained a common mistake (the provision that funds could only be transferred after registration of transfer of the property to the property investment companies) which recurred as a result of a bona fide "copy and paste" mistake during drafting of the prospectuses. Sharemax argued that the prospectuses should be rectified.

3.6 ACT forwarded the final report in terms of Section 45 (3) after receipt of the response of Sharemax and it stated in the report that ACT was of the opinion that a reportable irregularity did indeed take place. (emphasis added)

4. Ad paragraph 10 (e):

4.1 ACT is not in a position to respond to this enquiry and the enquiry should be directed to Weavind and Weavind.

5. Ad paragraph 10 (f)

5.1 The issue of payment of interest was set out in prospectuses. We refer you to section 4 of the prospectuses."

[78] In the Siegrist determination I expressed the view that the payment of investors' funds from the attorneys trust account to Sharemax was irregular and contrary to the undertaking in the prospectus. This view has now been

confirmed by Sharemax's auditors and they reported the irregularity to the regulator. However of concern to this office is the following:

78.1 the auditor does not state when the irregularity was discovered;

78.2 the auditor does not say when the irregularity was reported;

78.3 the auditor gives no detail as to the circumstances that led to the discovery of the reportable irregularity;

78.4 the auditors gave no details as to what steps were taken by them to ensure investor protection; and

78.5 the auditors must have known that the investors' funds were being used to fund the building of the mall and that interest payments, of 12%, to the investors also came from their own funds.

[79] What is startling are the contents of paragraphs 3.4 to 3.6 of the auditor's letter, highlighted above. It appears that the directors of Sharemax are claiming that there was a mere "copy and paste" error in the prospectus. This is disingenuous and against the probabilities. This is a material term of the contract between Sharemax and the investors. Most investors would not have participated if their funds did not enjoy the protection of an attorneys trust account. This simply cannot be swept under the carpet as a "copy and paste" error. Equally it is far too late to even consider a rectification of the prospectus, large numbers of investors already parted with their funds.

[80] The auditors do not give any details as to when Sharemax discovered this error and what action, if any, was taken to inform investors. Sharemax cannot

now simply call for the “rectification” of the prospectuses. As I understand the law, rectification of a contract can take place where there was common error between the contracting parties. There is no prospect of this. It is highly improbable that an error could have been made with what is an essential or material term of the contract.

[81] The information received by this office is that representatives specifically told investors that their money will remain in the attorney’s trust account and will only be paid out upon registration of transfer of the property. The investors were told to pay their money only to and directly into the attorneys’ trust account. There the money will be safe. The prospectus provides the following, which is a term of the contract with the investor:

“The effective date of the property syndication will be on date of registration of transfer of the Immovable Property in the name of Sharemax Zambezi Retail Park which is expected in or about November 2009. All moneys received from investors of the Company will be deposited in a trust account with the Attorneys who shall control the withdrawal of funds from that trust account.”

[82] The prospectus is carefully worded and drafted, there is no prospect that such a serious error was committed and which error went undetected. The auditors plainly did not accept the version that this was a rectifiable “copy and paste” error and formed an opinion that there was a reportable irregularity. In Siegrist I pointed out that there was an irregularity and the directors of Sharemax and the Attorneys were called upon to explain. Their explanation, which I found unacceptable, is dealt with in that determination.

[83] Incidentally, this office is in possession of promotional pamphlets produced and distributed by the second respondent. This pamphlet has a bold heading as follows; *"Jy moet in een van Sharemax Investments se projekte bele*". Of relevance is a paragraph that reads as follows; "*Jy het gemoedsrus oor jou belegging omdat: Geen geld word deur die beleggers by Sharemax Investments direk bele nie. Beleggingsfondse word in Weavind & Weavind prokureurs, wat reeds sedert 1905 bestaan, se trustrekening inbetaal waar dit onder die beskerming en versekering van die Prokureursorde van Suid Afrika is totdat die geld vir die koop van die winkelsentrum aangewend word, slegs wanneer die oordrag van die eiendom in die naam van die beleggers plaasvind."*

[English version]

"You must invest in one of Sharemax Investments' projects. You have peace of mind about your investment because: No investor's funds are ever invested directly with Sharemax investments. Investment funds are paid into the trust account of Weavind & Weavind attorneys (established in 1905), which falls under the protection and insurance of the Law Society of South Africa, until the property is ready for transfer into the investors' names."

[84] This statement is consistent with the representations made in the prospectus and its purpose is to assure investors that their funds enjoyed protection. On the second to seventh's own version they knew, at the time of producing this pamphlet, that they were willfully and deliberately misleading members of the public as they equally knew that this protection offered in the prospectus and

in this pamphlet was merely a “cut and paste error” and that the prospectus was subject to rectification. This pamphlet was distributed in 2010.

[85] This Office knows of no communication to the general body of investors and to members of the public, nor to the representatives, that this was a common mistake and a “cut and paste error”.

[86] This pamphlet also states that; “ *Die beleggers het elke winkelsentrum kontant aangekoop en daar is dus geen verband van ‘n bank daaroor nie.”* This is also, to the knowledge of the second to seventh respondents, factually untrue. In respect of Zambezi Mall and The Villa, investors’ money was actually used to fund the development of the malls. In fact, as the Reserve Bank correctly suspected, the second respondent was conducting the business of a bank with investor’s money. This was never disclosed to the investors.

[87] After every investment was made, each investor received a letter from second respondent acknowledging the investment. In this letter the following is stated: “*your investment is deposited into Weavind & Weavind’s trust account, and is kept there until the investment amount is processed and the property is transferred. After this your shares are issued to you as described in the prospectus.”* This is equally untrue and misleading since, on the second respondent’s version, this was a mistake. These letters of confirmation were still being written to investors after the “mistake” was discovered.

[88] The only reasonable conclusion to be drawn from this conduct is that the second to seventh respondents were involved in a scheme calculated to defraud members of the public.

Independent Regulatory Board for Auditors (IRBA)

[89] On the 5 November 2010 ACT wrote a letter to IRBA in terms of section 45(1) of the Auditing Professions Act 26 of 2005 (AP Act). ACT was writing in its capacity as the appointed auditor for Sharemax Zambezi Retail Park Holdings LTD and The Villa Retail Park Holdings LTD. In this letter ACT reported that they have reason to believe that a reportable irregularity had or is taking place. The details of the irregularity were that these companies had paid out investors' funds out of the attorney's trust account before the relevant companies took transfer of the property. This was contrary to the material terms of the prospectus, in particular paragraph 19.10. This clause provided that the investors' funds will remain in the attorneys trust account until "*in respect of successful applications until the minimum subscription is received and the immovable property have [sic] been transferred to The Villa"* (or in the case of a Zambezi prospectus "*the Zambezi"*).

[90] The letter then points out that transfer of the immovable property had not taken place but investors' funds were not retained. Incidentally, transfer of the properties has still not taken place.

[91] On the 12 November 2010 IRBA acknowledged receipt of the report and drew ACT's attention to the provisions of section 45 (3) of AP Act. This essentially

required the directors of the companies to respond to the allegation of reportable irregularity.

[92] On the 6 December 2010 ACT wrote to IRBA stating that they complied with the provisions of section 45(3)(a) and (b) of AP Act. The auditors also reported that the suspected irregularity is no longer taking place and that "no further payments will be made". This letter also informed IRBA that the management of these companies is of the opinion that no reportable irregularity took place.

[93] On the 6 December 2010 an attorney, Pierre Marais, representing the directors of the companies, wrote a lengthy letter to IRBA in which they explain why, in their opinion, no reportable irregularity was committed. I will briefly deal with this letter.

[94] The letter commences with a reference to the definition of "a reportable irregularity" in the AP Act. Then follows the submission that neither the second respondent nor its directors committed any conduct which is consistent with this definition. They also state that the directors of the companies did not control the trust accounts into which the investor's money was paid. This was a vague attempt at blaming attorneys Weavind and Weavind.

[95] The irregularity being addressed in this letter concerns the payment of investors' money from the attorney's trust account before the property was transferred. The letter, which runs into 21 pages, contains a lengthy and convoluted explanation that it was never intended that the money will remain

in trust. That the terms of the prospectus, providing for the money to remain in trust until the property is transferred, was the result of an "error common to the parties" and falls to be rectified. The error is explained as "a cut and paste error" committed by the attorneys.

[96] It is common cause that the terms of the prospectus represent the terms of a contract between the investor and the second respondent. The prospectus, paragraph 19.10.3, provides that the investors' funds will remain in an attorneys trust account "*until the minimum subscription is received and the immovable property have [sic] been transferred to Sharemax Zambezi Retail Park".* In plain terms, investors were promised that their funds will remain in an attorneys trust account until the property is transferred to the syndication company in which the investor invested. This is the term which the second to seventh respondents' claim must be rectified on the basis that it represents a common mistake between the parties.

[97] It is worth revisiting the provisions of Notice 459 of 2006, which provides for investor protection in respect of property syndication. There can be no doubt that the second respondent's investment scheme is subject to the terms of the said Notice. Indeed the respondents' prospectus complies with the terms of the notice. This compliance can be found in paragraph 19.10 of the prospectus, the very paragraph which the respondents now contend must be rectified.

[98] Notice 459 of 2006 provides as follows:

"Investor protection

(a) Investors shall be informed, in writing, that all funds received from them prior to transfer/finalisation shall be deposited into the trust account of a registered estate agent, a legal practitioner or a certified chartered accountant and provided that such trust account is protected by legislation. Individual investors are to be given written confirmation thereof. It shall be clearly stated who controls the withdrawal of funds from that account. Such an account shall be designated XYZ Attorneys/auditors/estate agents Trust Account- the xyz syndication". In the event of investors paying by cheque, promoters shall ensure that the name of the payee is printed in bold on the application forms.

(b) Funds shall only be withdrawn from the trust account in the event of registration of transfer of the property into the syndication vehicle; *or underwriting by a disclosed underwriter with details of the underwriter; or repayment to an investor in the event of the syndication not proceeding."*

Emphasis added.

[99] Paragraph 19.10 of the prospectus provides as follows:

"*19.10 All application monies received in terms of this Offer will be administered in trust by the Attorneys and retained by the Bank in a separate interest-bearing bank account opened and controlled by the Attorneys for each and every Applicant in terms of Section 78(2A) of the Attorneys Act, 1979 under Account Name : Weavind & Weavind Trust Account, Nedbank Pretoria, Branch Code 160445, Account No*

1604 067 896 (and the investor by completing the application form and/or affixing his signature thereto, thereby consents to such investment being made) either 19.10.1 until the refund cheques are issued and posted by the Promoter in terms of paragraph 19.9 above;

19.10.2 in the event of the Investor granting its consent as envisaged in paragraph 19.9 above, until such time as the Investor gives further instructions as to the manner in which such monies should be dealt with; or

19.10.3 in respect of successful applications, until the minimum subscription is received and the Immovable Property have been transferred to Sharemax Zambezi Retail Park." Emphasis added.

Plainly the wording of this paragraph was intended to show compliance with notice 459 0f 2006. Paragraph 19.10.3 could not conceivably be a "cut and paste error" committed by an attorney, especially not Weavind and Weavind.

[100] The respondents, in their letter to IRBA, now suggest that the prospectus, paragraph 19.10.3, be rectified to read as follows:

"*19.10.3 in respect of successful applications, until the minimum subscription is received* ***whereafter it shall be used for purposes of payment in terms of clauses 4.3 read with 5.7, 5.8. 5.11 .2 and 8 of this prospectus."***

What this means is that the investors' money will not enjoy the protection of an attorney's trust account but will be lent to the developer for purposes of building the shopping mall. The prospectus will then not comply with notice

459 and more importantly, the Department of Trade and Industry would not have approved of the prospectus. Equally investors would not risk their money. Paragraph 19.10.3 is clearly a material term of the contract between the parties. This cannot, on any version, be a mistake brought upon by a "cut and paste error". Incidentally, it is not possible, in law, to use forensic engineering to contract out of the law.

[101] In their letter to IRBA, the respondents failed to provide the following necessary information:

101.1 When did the second to seventh respondents discover that there was an error in the prospectus?

101.2 Bearing in mind that the prospectuses were repeatedly issued between 2007 and 2010, the second to seventh respondents failed to explain why it was only after a complaint was made to IRBA in 2010, did they discover that there was a "common error" in the prospectuses.

101.3 No information was provided as to when, if ever, investors were informed of the error in the prospectus.

101.4 Second to seventh respondents failed to explain why, in promotional materials produced by second respondent and distributed to members of the public and in correspondence to each investor after an investment was made, second respondent repeated the provisions of paragraph 19.10.3 assuring investors that their money was safe in an attorney's trust account. This office knows of no correspondence that informed investors and representatives that there was a "copy and

paste error" in the prospectus and that their funds will be used to finance the building operations.

101.5 Second to seventh respondents failed to say when, if ever, the mistake in the prospectus was pointed out to the Department of Trade and Industry and the Registrar of Companies.

101.6 Second to seventh respondents failed to explain why this "error" was only discovered after the Reserve Bank intervened in 2010 and after the scheme had already collapsed. It was too late to claim any form of rectification of the prospectus.

101.7 Respondents failed to explain why the attorneys, Weavind and Weavind, who allegedly made the mistake, did not file any papers or correspondence in support of the version that they had made a "cut and paste error". Nor is there any explanation as to why the said attorneys failed to inform investors that there was an error before they started paying the funds out of their trust account.

101.8 Second to seventh respondents failed to point out to IRBA that Weavind and Weavind have never supported the notion of an error in the prospectus. In fact the respondents obtained an opinion from Weavind and Weavind that notice 459 of 2006 did not apply to this scheme and therefore it was not illegal to pay the money from trust. This had nothing to do with any error in the prospectus. Incidentally, Weavind and Weavind never informed any investor that notice 459 did not apply and that second respondent could have access to their funds before transfer of the property took place.

[102] The conduct of ACT in reporting the irregularity only in 2010 raises serious questions.

I have to conclude by saying, it is unfortunate that in respect of Sharemax investments the following occurred:

102.1 No one noticed that important schedules were missing from the prospectus, eg the sale of business agreement.

102.2 Attorneys Weavind and Weavind failed to observe notice 459, which is there for the protection of investors.

102.3 The auditors, ACT now known as Advoca, failed to report the irregular transaction to IRBA timeously. They ought to have known that investors' funds were being paid before transfer had taken place. At all times they had access to that information. Also, they ought to have known that this money was ultimately lent to the developers who borrowed the money and used the same funds to pay 14% interest back to Sharemax.

Second to seventh respondents

[103] On the 24th February 2012 written notices in terms of section 27 of the Act were delivered to the second to seventh respondents. No formal response to these notices were received. This determination is therefore made on the basis of information available to this office.

[104] I now turn to the letter written by Sharemax on the 4th November 2008. This letter is signed by the fifth respondent; the relevant portion is quoted above. Significantly this letter, described as a "special memorandum" is addressed to "*managers, consultants and financial advisors of Sharemax".* The third paragraph reads as follows;

"It is Sharemax's responsibility to inform you, as financial advisor, concerning any situation that may affect the project, whether negative or positive."

[105] In their response to the complaint in Siegrist, the second to seventh respondents, with the exception of third respondent, specifically denied that they had anything to do with the brokers stating that the latter were either independent or registered as representatives of the third respondent. This letter contradicts this. Clearly the fifth respondent is communicating directly with brokers and refers to them as "Financial Advisors of Sharemax investments". As I found in Siegrist, Sharemax was not independent of the broker network, it in fact, through USSA, set up this network to market Sharemax products.

[106] This letter was circulated for the single purpose of enticing both brokers and investors into investing in Zambezi. The fifth respondent, with the blessing of his fellow directors, misled the public into believing that a return of up to 50% was possible after only one year. This is an extravagant promise that the directors of Sharemax knew was not possible to meet. Everyone knows today that the Zambezi was not sold to a pension fund. It is still unsold. In fact it is currently an empty shopping mall which generates no income. From

information published by Frontier Asset Management, which currently administers second respondent's property portfolio, this office knows that there is a serious problem with access roads to the mall. It will take over a year to rectify this and will cost many millions of rands. The information in the above letter was entirely misleading. It also amounted to reckless conduct. The fact that so many brokers, including the first respondent, believed the contents of this letter speaks volumes for their competence and lack of concern for their clients.

[107] The directors of Sharemax deliberately misled the investors into investing in Zambezi by making extravagant promises that were not possible to satisfy. It is noteworthy that whilst the letter promises this return after only one year, the Sharemax application form and disclosure documents promise no such return. In fact the documents warn the investor that this is a long term investment where capital may be at risk and that income is not guaranteed. The directors of Sharemax must be held accountable for this.

[108] For reasons set out in Siegrist, I find the directors of Sharemax, fourth to seventh respondents, to be personally liable for the complainant's loss. Similarly I find the second respondent, represented by its business rescue practitioner, and third respondent, in liquidation, liable for the complainant's loss.

Consequences

[109] For reasons set out above, the first respondent did not conduct himself in a manner as contemplated in section 2 of the Code. The first respondent's breach of the Code resulted in loss to the complainant. The complainant lost income and has lost her capital as well. The first respondent is liable to pay the complainant compensation for the latter's loss.

[110] Equally, for reasons set out above the second to the seventh respondents' (as licensed FSPs, product providers, principals in terms of section 13, key individuals and directors) breach of the Act and Code resulted in the complainant's loss.

[111] The facts before this office support the conclusion that the investment, as promoted and executed by Sharemax, was nothing more than a Ponzi scheme. The directors of Sharemax violated the law and on this basis too they must be held liable for the investors' loss.

G. QUANTUM

[112] The complainant made two investments in Zambezi of R190 000 – 00 and R300 000 – 00 respectively. The amount of the compensation is accordingly the amount of R490 000 – 00 plus interest.

[113] Both Botha and Brand pointed out that the complainant "was paid 12% interest". The purpose of this must be the suggestion that any award to the complainant must account for the interest already paid, that a possible set off be applied. This suggestion is misdirected.

[114] Sharemax was contractually bound to pay the complainant 12% interest; this was not merely a windfall. Equally Sharemax, through their brokers, represented to the complainant that her capital will be safe. There can be no basis in law to reduce the amount of the capital by the sum total or any fraction of the interest payments made to the complainant. Besides, the respondents cannot benefit from the fruits of their own Ponzi scheme.

[115] I refer to the following cases:

Trotman v Edwick 1951 (1) SA 443 at 449 SCA

De Jager v Grunder 1964 (1) 446 SCA

Scoin Trading (Pty) Ltd v Bernstein NO 2011 (2) 118 SCA

In addition I find that the award made to the complainant is fair compensation as contemplated in section 28(1) (b) of the Act.

H. ORDER

[116] In the premises the following order is made:

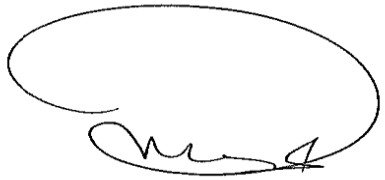
1. The complaint is upheld;

2. Respondents are hereby ordered, jointly and severally, the one paying the other to be absolved, to pay to complainant the amount of R490 000, 00;

3. Upon compliance with the order, the share certificate is to be tendered to respondents according to payment.

4. Interest at the rate of 15.5 %, per annum, seven (7) days from date of this order to date of final payment;

DATED AT PRETORIA ON THIS THE 16th DAY OF MAY 2013.



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