THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS
PRETORIA

CASE NUMBER: FAIS 09068/10-11/ WC 1

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In the matter between:

JACOBUS JOHANNES CARSTENS **First Complainant**

GERTRUIDA HENDRIKA CARSTENS **Second Complainant**

and

PAARL FINANCIAL ADVISORS CC **First Respondent**

JOHANN ANTON BARTMAN **Second Respondent**

DETERMINATION IN TERMS OF SECTION 28 (1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT, (ACT 37 OF 2002), (the Act)

A. THE PARTIES

[1] First complainant is Mr Jacobus Johannes Carstens, an adult male pensioner. Second complainant is Mrs Gertruide Hendrika Carstens, an adult female pensioner and wife to first complainant. Their full particulars are on file with the Office.

[2] First respondent is Paarl Financial Advisors CC, a closed corporation duly incorporated in terms of South African law, registration number 2001/081040/23, with its principal place of business at 16 Optenhorst Street, Paarl, Western Cape. First respondent is authorised as a financial services provider in terms of the FAIS

Act, with license number 11078. Respondent has been authorised since 22 December 2004 and the license is still valid.

[3] Second respondent is Johann Anton Bartman, an adult male and key individual of first respondent in terms of the FAIS Act whose address is 6 Optenhorst Street, Paarl, Western Cape. At all material times complainant dealt with second respondent.

[4] I refer to first and second complainants as complainant and to first and second respondents as respondent. Where appropriate I specify.

B. FACTUAL BACKGROUND

[5] During the month of July 2010, first and second complainant concluded agreements with Iprobrite (Pty) Ltd, a public company duly incorporated in terms of South African laws, with registration number 2009/007170/06. Iprobrite was represented by Purple Rain Properties 15 (Pty) Ltd t/a Realcor Cape[1]. The agreement was in connection with the purchase of debentures in the Blaauwberg Beach Hotel, Erf 19390, which were recorded as follows:

5.1 In respect of first complainant, debentures worth R150 000 were purchased on 8 July 2010; and R200 000 on 15 July 2010.

5.2 In respect of second complainant debentures worth R150 000 were purchased on 15 July 2010.

[1] Registration number 1997/004873/07

About Realcor

[6] Realcor was an authorised financial services provider registered with the Financial Services Board, under license number 31351. Realcor used various subsidiary companies for purposes of obtaining funding from the public for its development projects, which included Grey Haven Riches 9 Ltd, Grey Haven Riches 11 Ltd, and Iprobrite Ltd (hereinafter, collectively referred to as "Realcor").

[7] Midnight Storm Investments 386 Limited[2] ("MSI"), was a public company which owned the immovable property on which the hotel was being constructed.

[8] Realcor subsidiaries raised money by issuing the investing public with one (1) year and five (5) year debentures and various classes of shares[3]. In this way Realcor was able to raise substantial amounts of money from the public, funds which were mainly earmarked for the construction of the hotel.

[9] The debentures and shares were marketed as attractive on the basis that investors would receive monthly interest payments and dividends before and after the construction of the hotel. The target market was mainly the elderly or adult persons making provision for post-retirement income. Whilst an ordinary bank savings account would fetch a single digit interest per annum at the time, Realcor investors were promised more than 10% interest per annum. In the absence of legitimate economic activity that would generate cash inflows, it was not clear how this return was to be achieved.

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2 Registration number 2007/01927/06

3 The capital structure involved a combination of a share and a debenture/loan and conversion of debentures into shares. Whilst a debenture earns interest, a shareholder is entitled to a dividend provided they are declared and there is profit available for distribution.

[10] Meanwhile the investment was marketed as safe and guaranteed, with minimal risk of loss of capital as the investment was in "property" such as the hotel.

[11] Pursuant to concerns and allegations raised by members of the public that Realcor was obtaining money from the public unlawfully, the South African Reserve Bank (hereinafter, the "Reserve Bank"), on 21 April 2008, conducted an inspection of Realcor's affairs through PriceWaterhouseCoopers ("PWC") in terms of Section 12 of the South African Reserve Bank Act[4].

[12] Through the inspection, the Reserve Bank found that Realcor had conducted the business of a bank without being registered or authorised to operate as such. Realcor was thereafter placed under supervision and on or about 28 August 2008, the Reserve Bank appointed PWC as managers of Realcor. The Reserve Bank further prohibited Realcor from obtaining further deposits from the public, and took steps, by appointing PWC, to ensure that investors' money was repaid.

[13] Iprobite was liquidated on 25 October 2011, following the granting of a voluntary order by the High Court.

[14] The application for liquidation of MSI proceeded on 16 August 2012 and during May 2013 the hotel was sold for R50 million, dashing any hopes of investors to recoup their investments.

About Complainants

[15] At the time of concluding the agreements, first and second complainants were pensioners aged 72 and 69 years, respectively. First complainant says he worked

[4] Act No 90 of 1989

until the age of 69 to ensure they had sufficient provision for their retirement. The investment in Realcor came from an ABSA investment, which matured in July 2010. After consulting respondent, complainants agreed to invest in Realcor. Respondent describes complainants as moderate conservative investors.

[16] Complainants state that they received interest payments for the first three months following conclusion of the contract and no more. Their last interest payment was in September 2010. Complainants state that since losing the monthly income provided by Realcor, they have been struggling to make ends meet. Complainants are of the view that they have lost their investment.

C. THE COMPLAINT

[17] The basis of the complaint against respondent is the latter's failure to render financial services in line with the FAIS Act and the General Code, which includes respondent's failure to appropriately advice complainants and disclose the risk involved in the Realcor investment. Based on their longstanding relationship with respondent, complainants claim to have relied on respondent to provide them with suitable and appropriate advice.

D. RELIEF SOUGHT

[18] Complainants seek reimbursement in the amount of R500 000, which is comprised of first complainant's two investments of R150 000 and R200 000, as well as second complainant's investment of R150 000.

E. RESPONDENT'S RESPONSE

[19] During May 2011, the complaint was referred to respondent in terms of Rule 6 (b) of the Rules on Proceedings of this Office, to resolve it with complainant.

Respondent duly responded on 30 May 2011, and provided copies of the following documents:

19.1 Marketing agreement indicating that second respondent acted in his capacity as a representative of Realcor Cape.

19.2 Disclosure document to inform complainants that second respondent was acting under the supervision of Realcor Cape.

19.3 Needs and risk analysis which confirmed complainants as moderate conservative investors. Respondent referred to the outcome of the analysis, as his reason for recommending debentures, as opposed to shares.

19.4 Record of advice for second complainant.

19.5 Correspondence from respondent addressed to Realcor requesting their assistance to cancel complainants' investment.

19.6 Various correspondence addressed to Realcor on behalf of complainant.

[20] Having failed to resolve the matter with complainants, respondent filed a comprehensive response dated 30 September 2011. The essence of respondent's response is set out in sub-paragraphs 20:

20.1 Respondent stated that complainants had been his clients since 1997. First complainant was a co-director of a group of building contractors. Respondent took it that complainant was familiar with the building industry.

20.2 Respondent did not approach complainants with a view to market Realcor as an investment. Complainants made an appointment with respondent to

discuss investment opportunities that would provide higher monthly income than a commercial bank.

20.3 Three investment options were discussed, namely, a bank investment, Realcor Cape Debentures, and Sanlam Glacier. Respondent claims the choice was made by complainants; he did not prescribe.

20.4 Respondent states that he explained the products and the due diligence conducted on Realcor. Second complainant opted to invest R150 000 with Realcor Cape, and R200 000 in Sanlam Glacier. First complainant invested R150 000 with Realcor. A couple of days later, first complainant unilaterally decided to invest a further R200 000 in Realcor, indicating he was, "going to take the chance".

20.5 According to respondent, complainants were well acquainted with Mr Wimpie Nortje of Realcor[5] therefore, had access to the business and any additional information they needed. This was denied by complainants who indicated that they knew Nortje's father from years ago.

20.6 Respondent reiterated that he conducted his due diligence on the syndication. The fact that Realcor was licensed with the FSB and had Moonstone as its compliance officer created the necessary confidence with respondent that it was a safe investment, which is why he agreed to be a representative. Respondent further claims to have presented the financial statements to his accountant for approval. That Realcor had been in

[5] Wimpie Nortje is Willem Burger Nortje, one of the directors of Iprobrite and Key Individual of Realcor Cape in terms of the license issued by the Regulator, (the FSB).

business for 15 years, gave respondents the assurance that the investment was secure, so claims respondent.

20.7 Respondent claims to have invested his own money in the syndication.

20.8 Respondent stated that commission and costs were disclosed

20.9 Complainant signed and acknowledged that "*specific, isolated and focused advice was being provided and that there may be limitations on the aptness of the advice"*. In this regard, respondent claims to have advised complainant to undertake their own investigations and evaluate the product in order to decide whether respondent's advice was applicable to their own situation, based on their objective, financial situation and specific requirements, before giving the instruction to implement their chosen investment option. Incidentally, this is the duty of a provider, in terms of section 8 (1) of the General Code. A provider is only allowed to deviate from the requirements of section 8 (1) where the requirements of section 8 (4) are satisfied.

20.10 Complainants were assured that the investment in Realcor was not the same as Sharemax or "Kings". Respondent in this regard relies on a disclosure prepared by Moonstone[6] that the investment was safe, given that the debenture issued by the Realcor companies was not the same as those of a syndicate, where the income is dependent on rental income. Furthermore, the investment capital was secured by property bought by the company in whose name the debenture was issued.

[6] Moonstone describes itself as an uncompromised and independent provider of services to Financial Service Providers.

20.11 Respondent further noted that the unlisted shares were considered to be higher risk, as opposed to the debentures. In light of the risk profiling, which indicated complainants to be a “moderate conservative” investors, respondent is of the view that the debentures were more suitable to the needs of complainants.

20.12 Respondent concluded that the advice was provided in good faith. Respondent states that he cannot understand how an advisor can be held responsible for governance failures over which he had no control. Despite valiant efforts to recover the investments, respondent was unable to do so.

[21] Complainants were provided with an opportunity to comment on respondent’s reply. It would appear that from the onset, respondent was adamant to sell the Realcor investment to complainants. Respondent assured complainants that there were no inherent risks.

[22] On 29 June and 1 July 2015, notices in terms of Section 27(4) were issued, advising respondent that the Office had accepted the matter for investigation and further informed respondent that in order for the Office to begin its investigation, respondent had to provide all documents and or recordings that would support its case. The notice further indicated to respondents that in the event the complaint was upheld, they could face liability. Respondent replied on 2 July 2015, referring the Office to previous responses.

[23] Further notices in terms of Section 27 (4) were sent on 16 July 2015, confirming that the matter will be referred for determination in terms of Section 28 of the FAIS Act.

F. DETERMINATION

[24] The issues for determination are:

24.1 whether respondent, in rendering financial services to complainant, violated the Code and the FAIS Act in any way. Specifically, the question is whether complainant was appropriately advised, as demanded by the Code; and

24.2 in the event it is found that respondent breached the Code and the FAIS Act, whether such breach caused the loss complained of; and

24.3 the amount of the damage or financial prejudice.

G. LEGISLATIVE FRAMEWORK

[25] I deem it necessary to first isolate the legislative framework relevant to this matter:

25.1 Sections 13 (2) (b); 16 (1) and (2) of the FAIS Act;

25.2 The General Code of Conduct for Authorised Financial Services Providers and Representatives, in particular, Sections 8 (1) (a) to (c); 8 (4) (a); and 7; and;

25.3 Government Notice 459 (published by means of Government Gazette 28690 of 2006), (the notice).

Whether complaint is directed at the appropriate party?

[26] It is appropriate that I deal with respondent's submission that this complaint is directed at Realcor, based on its failure to perform in terms of the contract, and not

against respondent. This is incorrect. As can be seen from the complaint, the basis of complainants' complaint is respondent's failure to appropriately advise them.

[27] I must also deal with the question whether, given respondent's claim that he was acting as Realcor's representative, it is correct that he be saddled with liability arising out of failure of this investment. To answer this question attention should be given to the definition of a representative[7], which assumes that a person acting as a representative has to exercise the relevant final judgment; decision making and deliberate action inherent in the rendering of a financial service to a client[8].

[28] In *Moore versus Black*[9], the Appeal Board stated as follows;

"In effect a "representative" executes the very same acts as are expected from the provider when operating alone with the exception of when a representative either:

1. Acts on behalf of the provider;

2. Subject to the provider concerned taking responsibility for these acts.

Apart from these two (2) qualifications, a representative acts as if it were a provider.

…The provider is directly regulated by the FAIS Act and by the Registrar. But representatives are, apart from being regulated by the FAIS Act, in effect regulated by the overseeing provider rather than by the Registrar. Such provider clearly has a discretion on how precisely to exercise responsibility over a representative but

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7 Section 1 Financial Advisory and Intermediary Services Act 37 of 2002 'representative 'means any person, including a person employed or mandated by such first-mentioned person, who renders a financial service to a client for or on behalf of a financial service provider, in terms of conditions of employment or any mandate, but excludes a person rendering clerical, technical, administrative, legal, accounting or other service in subsidiary or subordinate capacity…

8 *Nell v Jordaan* FAIS 05505-12/13 GP 1

9 In the Appeal Board of the Financial Services Board, John Alexander Moore and Johnsure Investments CC / Gerald Edward Black, 15 January 2013 at para 59 and 61

should ensure in the agreements with the representative that the responsibility covers all aspects, including those duties and obligations imposed by the FAIS Act and the Regulations pertaining to them. The fact that the representative "acts on behalf of" the provider also means that in law, the provider may be held accountable for the acts and omissions of his representative and thus should be regarded as a co-respondent in the event of negligence on the part of the representative."

[29] The question of whether a representative [and not the provider] should be held liable, in this context, was again dealt with by the Board of Appeal in the second *Black v Moore* Appeal[10]. Appellants, relying on Board Notice 95 of 2003 argued that the responsibility rested not with the appellant as a representative but solely with the financial services provider. In dismissing the argument, the Board concluded, *'the effect of the Exemption Notice thus allows a representative (due to his minimum experience) to market products subject to a supervisor's guidance. Apart from this exemption, he has to comply with the Code of Conduct.*'

[30] Section 13 (2) (b) of the Act[11] states:

"An authorised financial services provider must take such steps as may be reasonable in the circumstances to ***ensure that representatives comply with any applicable code of conduct*** *as well as with other applicable laws on conduct of business*. (My emphasis).

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[10] Decision handed down on 14 November 2014, paragraphs 18 to 23

[11] Financial Advisory and Intermediary Services Act 37 of 2002

It is clear that there is a duty imposed on not only the provider but also the representative to comply with the provisions of the FAIS Act and Code of Conduct. The complaint is thus directed against the correct parties, one of whom is respondent.

Whether the investment promoted by Realcor Cape was a property syndication.

[31] In his own narrative, respondent vacillates between referring to the investment as a syndication while refuting that it was a syndication. He claims that Moonstone provided him with a document indicating that the investment is not a property syndication. Respondent however, failed to provide a copy of the document. It is therefore, apposite to dispose of the question whether the offer made by these companies, Realcor and its associated fundraising companies, was a property syndication offer, in which case, their prospectuses ought to have complied with Notice 459 of Government Gazette 28690.

[32] Property syndication refers to a direct property investment where the smaller property investor with limited available capital has an opportunity to invest in commercial, retail or industrial properties[12]. The main objective should be investing in properties with quality tenants, long-term leases, strong returns and good potential for capital growth[13].

[33] The sole purpose of inviting the public to invest in the three Realcor fundraising companies, namely, Iprobrite, Grey Haven Riches 9 and Grey Haven Riches 11,

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12 http://www.investors.asn.au/education/property/property-syndicates/;https://www.realtymogul.com/resource-center/articles/real-estate-syndication

13 http://www.investors.asn.au/education/property/property-syndicates/

was to acquire shares in the property holding company[14]. This proposition is not without problems for, not all the funds raised by these companies were paid to the property holding company. (I will return to this aspect later).

[34] The three entities were new, had no trading history and no intention of carrying on any other business other than facilitate the purchase of shares in the property holding company, Midnight Storm. Isolating for now the question of how the companies were able to pay interest and dividends to investors from the onset, given that none of the four, including Midnight, had funds to acquire the land and build the hotel. Nonetheless, the prospectus highlights that the funds collected from investors are to be utilised to construct the hotel.

[35] There is mention in the prospectus that the Property Holding Company (Midnight) may elect to sell before completion of the development of the hotel, provided the offer covers Midnight's liabilities[15].

[36] The prospectus further states that what is intended is that the Rezidor Group will operate the hotel for a period of twenty years. Realcor Cape has been allocated the task of procuring and had already procured the hotel operator, in terms of an agreement with the property holding company, for a fee. Surprisingly, respondent does not state what he made of the paucity of information regarding the agreement between the property holding company and Rezidor. Given that this was a critical element to the viability of the investment, it should have formed part of respondent's due diligence. Notwithstanding the silence of the prospectus in this regard, the

[14] Paragraphs 1.6, 1,7, 2.2, and 3.1 of the prospectus.

[15] Paragraph 1.7 of the prospectus

property holding company would have had to charge for the use of its property. It is from this benefit that investors would be paid, otherwise, the property holding company would find itself in default and worthless. Incidentally, respondent is silent on the terms of the agreement between the Property Holding Company and the investment companies.

[37] In simple terms, the rental that was to be generated by the property holding company would be utilized to pay the investors. There was no other way in which the property holding company could make money unless it was going to operate the hotel for its own benefit, which is not stated in the prospectus.

[38] Whether Midnight had elected to sell prior to completion of the hotel or gain financial benefit from the rental paid by the operator of the hotel, the inescapable conclusion is that investors' money was used for the acquisition[16] and development of the immovable property. The economic benefit for investors would come from the rental paid by the operator; or, the capital gain from selling the hotel. It follows that members of the public were invited to invest in a property syndication and the prospectuses issued had to comply with Notice 459.

Whether complainants were appropriately advised as required by the Code?

[39] Respondent was invited to demonstrate that he had conducted due diligence on Realcor, prior to advising complainant. Respondent indicated that its independent assessment of Realcor consisted of investigating 15 previous, similar projects, as

[16] The prospectus refers to a Mettle loan, that must be repaid by no later than 30 July 2010. The loan was used to acquire the land. Investors' funds will first be applied to settle this loan.

well as thorough investigation into the history of the company, going as far back as 1993[17]. Respondent further presented the financial statements of Realcor to his auditor for comment. Before going any further, the so called financial statements were three months' worth of management accounts. Interestingly, respondent does not disclose the period covered by the management accounts. Nonetheless, there is not much insight respondent would have gained from three months of management accounts.

[40] The offer made to the public by Realcor was communicated via a prospectus. Thus, respondent's efforts in assessing this investment and the company had to include this document.

[41] In order to get a better appreciation of the risks associated with a property syndication and the kind of disclosures that should have been made in order to properly advise complainants in terms of the FAIS Act, one has to refer to the statutory disclosures contained in the Government Gazette[18], Notice 459 of 2006 (notice 459).

[42] The notice contains minimum mandatory disclosures which must be made by promoters of property syndicates. The disclosures must be included in the prospectus. By extension, any provider who recommends this type of investment to clients, must deal with the disclosures when advising their client. The aim, as set out in the Gazette, is to protect the public. Some of the most pertinent provisions of notice 459 are highlighted below:

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17 This included projects such as Crystal Creek, Gordons Bay 2006, being nominated by NHBCR for the national award of builder of the year 2006, the Marsh Rose Mall project in 2007.

18 No 28690

a) Section 1(b) states that:

"Investors shall be informed in writing that:

(i) public property syndication is a long-term investment, usually not less than five years;

(ii) there is a substantial risk, in that the investor may not be able to sell his shares should he wish to do so in the future;

(iii) it is not the function of the promoter to find a buyer should the investor wish to sell his shares and that it is the investor's responsibility to find his own buyer."

b) Section 2 (a) requires that investors be informed that funds received from them prior to transfer will be held in an attorney's trust account. But more importantly, section 2 (b) states as follows:

"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."

d) Any direct or indirect interest which the promoter and or any of his or her family member or any other person who is actively involved in the promotion of that syndication has in the property to be purchased, shall be disclosed.

[43] Respondent is on record stating that his view was that the debentures were suitable for the two retired complainants. He saw no risk given the unlisted nature of the instruments and their illiquid nature. On the contrary complainants were informed that the investment was safe and suitable for their circumstances.

[44] Information available to this Office points to investors' funds being paid directly into the account of Purple Rain Properties 15 (Pty) Ltd, trading as Realcor, in contravention of section 2 (b) of notice 459.

[45] I have carefully analysed respondent's responses and cannot find a single reference to the notice. It appears to me that respondent was not even aware of the existence of the notice. Indeed, had respondent been aware, he would have realised that Realcor's prospectus undermined the provisions of the notice. In that case, respondent should have immediately ceased advising his clients about this investment.

[46] I have not seen anything in respondent's papers that indicates that he dealt with the requirements of section 2 (d) of the notice, given the overlapping interests in respect of the directors of the promoter, the investment companies, and the property holding company.

[47] Section 3 (c) of the notice states:

"The disclosure document, which is to be dated and signed by the promoter, shall contain a statement of proper due diligence (commercially and legally) with regard to the property and its tenants prior to the unconditional purchase thereof and he/she shall state that this was done and that he/she is satisfied with the results thereof."

[48] An examination of Iprobrite's prospectus shows Realcor's utter contempt for the law in so far as their duty to provide details of due diligence carried out in respect of the property. One can easily conclude from respondent's version that he had

made no attempt to satisfy himself that the prospectus complied section 3 (c) of notice 459.

About Realcor's / Iprobrite's offer

[49] After thoroughly examining the offer contained in Iprobrite's prospectus, I find that there was no information whatsoever which could have led any competent financial advisor to conclude that this was a sound investment, much less an investment suitable for conservative investors at a pensionable age. Below, I set out some of the provisions that should have led respondent to dissuade his clients against this investment. I comment as I go along:

49.1 At least 50% of the funds raised will be retained by Iprobrite to cover **undisclosed amounts in respect of**, corporate secretarial fees, professional advisory fees, and '*any other professional bodies'*. The remainder will go to Midnight for the completion of the hotel[19].

49.2 Iprobrite is to be managed by the Promoter (also the property developer). This means that investors' funds will be managed by the developer of the immovable property, Realcor Cape. The real beneficiary of the funds was also in charge of managing investors' money. I pause for a moment to note that the undisclosed amounts that were aimed paying amongst others, 'any professional bodies', must have set the scene for self-help on the part of those controlling investors' funds. In the world of collective investments, of which a property syndication is one, the functions of managing the building project and management of investors' funds are definitely segregated and

[19] Paragraph 5.2.2 of the prospectus

allocated to different entities. The two functions are never concentrated under one entity and this has to do with the protection of investors. From this point, respondent should have realised that he is not dealing with good stewards of investor funds and keep his clients' money away from this investment.

49.3 The directors of Iprobrite and Midnight have unlimited powers to borrow money[20].

49.4 At least three of the four directors are common in the Property Holding Company, the Promoter/Property developer, and the investment Companies, (Iprobrite, Grey Haven Riches 9 and 11). Ms Deonette De Ridder, who appears to have been the most dominant spirit behind the Realcor Empire, even had her family trust - the Deonette Trust - involved in the Realcor business[21]. The question that should have crossed respondent's mind should have been, given the real conflict of interest, which these four directors were bound to face in their daily decision making, who would mind the investors' interests? This shows the directors had no regard for sound corporate governance principles. Investors had no chance in this cesspit.

49.5 Ms De Ridder, in her capacity as managing director of the Promoter/Developer, is responsible for the overall management of construction of the hotel, administration of the investments companies and

[20] Paragraph 9.10 page 25 of the prospectus

[21] See page 25 of the prospectus.

has been instrumental in the procurement of Radisson Hotel as the operator to operate and manage Radisson Blu Hotel[22]. Yet another red flag that should have dissuaded respondent from considering this as an investment.

49.6 The prospectus states that Realcor Developments is in the process of becoming 100% shareholder of issued share capital in the Property Holding Company. There is no evidence that Respondent was concerned about Realcor Developments' acquisition of Midnight and what the consequences of this acquisition were for the investors. There is no mention that respondent took any steps to establish who was behind Realcor Developments.

[50] Before concluding, I noted from the prospectus that investors were charged a premium of R99.99 per share. Respondent has not provided any information to this Office regarding his reasons for concluding that the premium was justified. One might remember that this prospectus opened long after the South African Reserve Bank's investigation into Realcor, which saw the SARB prohibiting Realcor from further collecting investor funds. Notwithstanding, Realcor continued to collect funds from the public, aided by the likes of respondent and even added a premium to its shares. This was by no means an investment. Respondent gambled what complainants could not afford to lose.

[51] Turning to respondent's duties in terms of the FAIS Act, section 8 (1) of the General Code of Conduct provides that a provider must, prior to providing a client with advice:

[22] Para 9.13 of the prospectus

(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;'*

[52] In order to demonstrate compliance with section 8 (1), respondent provided a document entitled "Adviesrekord van 'n Onderlinge Ooreenkoms"[23]. This document states:

'The share class productive investment is considered as a venture capital investment and seeing that unlisted shares are not readily marketable, Realcor Cape and the representative undertakes to assist the shareholders to sell their shares at market related commission should such a need arise.

It is noted that potential fluctuations because of market conditions associated with property and prime lending rate could have a negative impact on the value of the investment portfolio. It is thus not possible to guarantee the investment capital or the target return and Realcor Cape cannot be held responsible for any losses in this regard. It is confirmed that the client understands and accepts the underlying market risks.'

[23] Translated to mean Record of Advice of an Underlying Agreement

[53] What complainant needed to know is a simple statement to the effect that they could lose all their capital in these investments. Complainants also needed to know that respondent had no resources to evaluate this investment, thus he was not in a position to advice. Had these two statements been made clear, the probabilities that complainants would have gone ahead with the investments are zero.

[54] Given the aforesaid discussion, I conclude that respondent was completely out of his depth and could not have appropriately apprised complainant of the risks involved, in violation of sections 7 of the Code.

[55] Respondent provided a document entitled “Diensvlak Ooreenkoms”, which translates to “service level agreement”. This document was completed for both first and second complainant, and with the investment in Realcor. The instruction according to the form, was to address a single need. The risk and needs analysis completed for both complainants classified them as moderate conservative investors. These type of investors wish for their capital to be guaranteed, along with some investment growth. It was of utmost importance for complainants, according to the completed questionnaire, to preserve their capital. Complainants therefore had no risk appetite.

[56] The section with regards to financial information, was left blank and marked as “not applicable”. Respondent did not obtain any information with regards to other investments, income and expenditure, or assets and liabilities. It is therefore not clear how respondent came to the conclusion that the chosen Realcor investment was appropriate for complainants’ circumstances at the time.

[57] What the Code contemplates in section 8 (1) is that a provider take into account necessary and available information for the purpose of conducting an analysis. At the time of the investment complainants were pensioners who utilised savings to make the investment with a need to preserve their capital. Notwithstanding, respondent saw it fit to invest their funds to an investment he did not understand in violation of section 8 (1) (c) of the Code.

[58] Of equal concern, is the fact that respondent shifted his duties as a provider to complainants, committed complainants to make investigations about the Realcor investment and conclude whether same was suitable for their circumstances, while he pocketed commission. His pitch to complainants was that the investment was suitable for their circumstances. Respondent made this statement without carrying out any independent work to assess the risk in the investment, in violation of section 3 (1) (a) of the Code, which enjoins providers to ensure that representations made are factually correct, adequate and appropriate, to ensure that the client is in a position to make an informed decision.

[59] Apart from the claim that first complainant had been involved in the building industry, respondent has provided no information to support his conclusion that complainant was *au fait* with this investment. The complexities involved in this investment remove it from the ordinary day to day experience of people in the building industry. Respondent's assumption that this investment concerned building is astounding. In any event, none of this exonerates respondent from his

duty to comply in terms of section 7 (1) (a)[24]. If first complainant knew anything about investments, he would have steered clear of the Realcor investment.

[60] It is respondent's argument that he saw the debentures less risky than the shares. The prospectus states that Midnight acquired bridging finance from an entity known as Mettle against the registration of a first continuing covering mortgage bond over the hotel (Mettle loan). The last instalment of the loan was payable on 30 July 2010. It is further stated that the Mettle loan ranks first, while the investment companies must be content with the reversionary rights after the Mettle loan is settled. There is no indication that respondent ever had sight of the Mettle loan agreement. There is no question, the loan and its terms added to the risk faced by the investors. Again, respondent failed to pay attention to this element of the investment, yet he informed complainants that the investment was safe.

Did respondent's conduct cause the loss?

[61] Based on complainants' version, the investment in the hotel was as a result of the respondent's advice. This means, had it not been for respondent's advice, complainants would not have made the investment in Realcor. This answers the test for factual causation.

[62] The next step is to establish whether, as a matter of public and legal policy, it is reasonable to impose legal responsibility on respondent for the failure of the investment. In other words, could respondent have reasonably foreseen the collapse of Realcor.

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[24] Section 7 (1) (a) stipulates that a provider must provide reasonable and appropriate general explanation of the nature and material terms of the relevant contract to his client, and make full and frank disclosures of any information that would reasonably be expected to enable the client to make an informed decision.

[63] The reasonable foreseeability test did not require that the precise nature or the exact extent of the loss suffered or the precise manner of the harm occurring should have been reasonably foreseeable for liability to result; it was sufficient if the general nature of the harm suffered by complainant and the general manner of the harm occurring was reasonably foreseeable.

[64] Given that respondent had carried out no due diligence on the Realcor group, it was negligent of him to advise complainants that the investment was safe. Respondent had no resources to assess this investment. On this basis alone, he should not have advised any client on this investment. That respondent could not see beyond the marketing papers written by Realcor was sufficient for him to foresee that harm may result. Thus, a skilled and responsible FSP, acting according to the Act and the Code, would not have advised complainant to invest in Realcor.

[65] If respondent did his work according to the Act and the Code, no investment in Realcor would have been made, bearing in mind complainants' tolerance for risk. It is easy and convenient to impute loss to director mismanagement or other commercial causes. In this case however, complainants' loss was not caused by management failure at Realcor but respondent's inappropriate advice. That the risk actually materialized, for whatever reason, is not important. Otherwise the whole purpose of the Act and the Code would be defeated. Every FSP can ignore the Act and Code in providing services to their clients and hope that the investment does not fail. Then when the risk materializes and loss occurs they can hide behind unforeseeable conduct on the part of product providers. This will fly in the face of public and legal policy and the provisions of the Act and Code.

[66] The loss suffered by complainants as a result of respondents' inappropriate advice was reasonably foreseeable by respondent. I refer in this regard to S*tandard Chartered Bank of Canada v Nedperm Bank Ltd*[25] where the Court held that:

"as to the issues of loss and causation, that although the untrue report issued by the respondent had been a factual cause of the appellant's loss, the test to be applied to the question whether the furnishing of the untrue report had been linked sufficiently closely or directly to the loss for legal liability to ensue was a flexible one in which factors such as reasonable foreseeability, directness, the absence or presence of a novus actus interveniens, legal policy, reasonability, fairness and justice all played a part."

[67] Information at this Office's disposal points to the following conclusions:

67.1 Respondent had no ability to assess the risk in this investment, yet he advised his clients that it was a safe investment and suitable for their risk profile.

67.2 As has already been demonstrated, respondent had no idea of the risk involved in this product. To even describe the investment as safe and suitable for conservative investors was negligent.

67.3 Whilst respondent is of the view that he had carried out due diligence, I have already dismissed this as nothing more than smoke and mirrors.

67.4 Respondent cannot deny that at the time he advised complainant, there was no apparent means to protect investors against director misconduct or

[25] 1994 (4) SA 747 (AD)

mismanagement. For this reason, harm was not only foreseeable; it was real.

67.5 There is equally no evidence that respondent had carried out any work to acquaint himself with the legal environment in which property syndications operate.

67.6 Respondent had failed to investigate the myriad of companies involved and the several agreements which left control of the all the companies in the hands of one small group of directors.

67.7 Respondent paid no attention to the real conflict of interest in respect of a number of individuals involved in managing the Realcor companies.

67.8 Had respondent adhered to the Code, he would have realised that complainants' circumstances were unsuitable to this type of investment.

67.9 It was respondent's insistence on selling this investment to complainant, regardless of the surrounding circumstances, that saw respondent violate his duty to act in the interests of his client and the integrity of the financial services.

H. CONCLUSION

[68] It boggles the mind that respondent saw this as an investment opportunity. Complainants worked through what they thought was a professional financial advisor because they thought that their interests would be better served. Sadly, and in complete disregard to his duties under the FAIS Act respondent gambled complainants' money. If only respondent has paid attention to the law, there would

have been no investment in Realcor. All of this reminds me of the saying, 'Fools rush in where angels fear to tread.'

[69] I find that, in advising complainant to invest in Realcor, respondent contravened sections 2; 7 (1) and 7 (2); 8 (1); and 9 of the Code. I also find that this conduct was the cause of complainants' loss.

I. QUANTUM

[70] Complainants invested a total amount of R500 000. There are no prospects of ever recovering the money from the hotel.

[71] Accordingly, an order will be made that respondents pay to complainants an amount of R500 000 plus interest.

J. ORDER

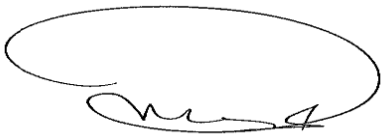
[72] In the premises, I make the following order:

1. The complaint is upheld;

2. Respondents are ordered to pay complainant, jointly and severally, the one paying the other to be absolved, the amount of R500 000;

3. Interest on the amount of R500 000 at the rate of 10.25%, seven days from the date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 12th DAY OF OCTOBER 2016



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NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS