IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NO: FAIS 03494-12/13 GP 1

In the matter between:

MATTHYS ADRIAAN ALBERTUS DE JAGER **Complainant**

and

HUIS VAN ORANJE FINANSIËLE DIENSTE BPK **First Respondent**

STEPHANUS JOHANNES VAN DER WALT **Second Respondent**

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

A. INTRODUCTION

[1] The complainant at the age of 56 invested an amount of R70 000 into Purple Rain Properties 15 (Pty) Ltd t/a Realcor Cape ("Realcor") on 30 November 2009. Realcor was an authorised financial services provider registered with the former Financial Services Board[1] under license number 31351.

[2] Realcor used various subsidiary companies for the purpose of obtaining funding from the public for its development projects. The subsidiaries included Grey Haven Riches 9 Ltd, Grey Haven Riches 11 Ltd, and Iprobrite Ltd (hereinafter, collectively referred to as "Realcor").

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[1] Now called the Financial Sector Conduct Authority, effective 1 April 2018

[3] The Realcor subsidiaries raised money by issuing the investing public with debentures and various classes of shares. In that way the Realcor group was able to raise amounts in excess of R600 million from the public, funds which were said to have been earmarked for the construction of the Blaauwberg Beach Hotel.

[4] The debentures and shares were marketed as attractive on the basis that investors would receive monthly interest payments and dividends, both before and after the construction of the hotel.

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

[6] At the time of making the investment, the complainant was assisted by the second respondent. In his complaint to this Office, the complainant makes the statement that several promises were made to him in respect of the investment, only for him to discover that Realcor Cape was bankrupt.

B. THE PARTIES

[7] The complainant is Mr Matthys Adriaan Albertus De Jager, an adult male whose full details are on file in this Office.

[8] The first respondent is Huis Van Oranje Finansiële Dienste BPK, (Huis van Oranje), a company duly incorporated and registered in terms of South African law, with registration number 1995/006025/06. Its principal place of business was noted as 1421 Collins Avenue, Moregloed, Pretoria. The first respondent was authorised as a financial services provider in terms of the FAIS Act, with license number 687, which lapsed on 11 July 2011.

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[2] Registration number 2007/01927/06

[9] The first respondent was represented by Mr Barend Petrus Geldenhuys, an adult male, key individual and authorised representative of the first respondent in terms of the FAIS Act.

[10] The second respondent is Stephanus Johannes van der Walt, an adult male and authorised representative of the first respondent (as provided for in the FAIS Act) at the time material hereto. The second respondent is now a representative of FNB Financial Advisory FSP 3075, with its principal place of business at FNB Century City Shop, 139 Canal Walk Shopping Centre, Century City, Cape Town, 8001.

[11] I refer to both the first and second respondents as "respondent". Where necessary, I specify which respondent is being referred to.

C. DELAYS IN FINALISING COMPLAINTS OF THIS NATURE

[12] The Office has taken long, admittedly, to attend to the matter. However, as previously communicated, there were a number of legal challenges that prevented this Office from proceeding with complaints relating to property syndication matters. Since the pronouncement of the Appeals Board (now the Financial Sector Tribunal) in the matters of *Siegriest* and *Bekker* (which saw the Office halt the processing of property-syndication-related complaints), we resumed with the processing of these complaints with the objective of finalising the outstanding matters.

D. THE COMPLAINT

[13] The complainant made an investment into Grey Haven Riches 11 Ltd in the amount of R70 000. Initially, the complainant received his dividends as promised at the rate of 12% on the amount invested. However, he noticed that something was wrong after he received his last payment on 15 February 2011, and nothing thereafter.

[14] The complainant complained to the respondent on the same day. The matter was however not resolved and the complainant eventually lodged a complaint with this

Office on 6 August 2012. He blames the respondent for the investment and wants an order compelling him to repay his investment in full, together with interest.

E. INVESTIGATION OF THE COMPLAINT

[15] The respondents were notified of the complaint and requested to resolve it with their client in terms of rule 6 of the Rules on Proceedings of the Office of the Ombud for Financial Services Providers on 13 August 2012.

[16] On 26 September 2012, the first respondent replied, suggesting that it was the complainant who had made contact with them about the investment. Without providing more detail, the respondent merely attached to his covering letter copies of FICA compliance documentation, risk analysis, Realcor application forms and Record of Advice. I shall return to the documents shortly.

[17] On 24 June 2015, a notice in terms of section 27 (4) of the FAIS Act was sent to the respondents wherein they were informed that the complaint had not been resolved. The respondents were invited to provide their full response to the complaint, explain the basis of their recommendation to invest to the complainant and provide all documents at their disposal to make their case. The respondents sent the same response they provided to the notice in terms of Rule 6 (b).

F. ANALYSIS AND RECOMMENDATION

The law

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

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

18.2 Section 3 (1) (a) of the Code states that when a provider renders a financial service, that:

(a) representations made and information provided to a client by the provider –

(i) must be factually correct;

(ii) must be provided in plain language, avoid uncertainty or confusion and not be misleading;

(iii) must be adequate and appropriate in the circumstances of the particular financial service, taking into account the factually established or reasonably assumed level of knowledge of the client;

(iv) must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction.

18.3 Section 7 (1) calls upon providers other than direct marketers to provide (a) 'reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision.

18.4 Section 8 (1) (a) to (d) of the General Code states that:

A provider other than a direct marketer, must, prior to providing a client with advice –

(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...*

18.5 Lastly, section 9 provides for the keeping of a record of advice which must reflect the following:

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

(b) *the financial product [sic] which were considered;*

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

(d) *where the financial product or products recommended is a replacement product as contemplated in section 8(1)(d) –*

(aa) *the comparison of fees, charges, special terms and conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided, between the terminated product and the replacement product; and*

(bb) *the reasons why the replacement product was considered to be more suitable to the client's needs than retaining or modifying the terminated product...*

Documentation

[19] The documents submitted by the respondents can be analysed as follows:

19.1 The record of advice contains a summary of the information upon which the advice was based. This information was typed on the form[3], and states the following:

a. No analysis of the client's financial position was done. The client did his own analysis.

b. In respect of the client's risk profile, it is noted that he manages his investment portfolio himself.

c. The client's needs have been noted as achieving the highest income on his investment, as soon as possible.

19.2 The products considered, were Realcor, Sharemax and PIC; all property syndication investments.

19.3 The declaration in the record of advice places the onus of the complainant to ensure that the advice were appropriate and in accordance with his needs.

19.4 The Realcor application form conveys that the funds were to be deposited into the account of Purple Rain Properties 15 (Pty) Ltd and the type of account is labelled as 'trust' with ABSA bank. I mention at this stage that the regulations contained in Notice 459 of Government Gazette 28690 (Notice 459) dictate that the funds be deposited into a registered trust account of an attorney, chartered accountant or estate agent, and further mandates that the funds are not to be paid out prior to registration of transfer into the property syndication vehicle. The FAIS Ombud has already established from ABSA bank that the account was not a registered trust account, but an ordinary savings account.

19.5 The application form further indicates that commission of 7% was payable to the second respondent, while 1 - 3% referral commission may be payable to

[3] It should be noted that this pre-populated information appeared standard on every form completed for a potential investor. I refer in this regard to the matter of Mostert v Huis van Oranje, FAIS 01417

institutions and individuals. (There is no indication from the paper work of whether anyone was paid a referral fee in respect of both transactions. From a risk point of view however, the door was already opened to pay unidentified individuals).

19.6 The application forms also confirm that the product comes with no guarantees and that the investor carries all the risk. No risk analysis were conducted, and there is no indication whether the complainant's circumstances were suitably matched with the risk inherent in this product, as the General Code of Conduct (the Code) demands in section 8 (1) (c).

[20] I refer to the attached Annexure which summarizes the disclosure documents pertaining to the investment companies, Grey Haven 9 and 11 and Iprobrite, on the one hand, and on the other, Notice 459. Had the respondent considered the content of these documents, he would have realised that the investments were not suitable for his client.

Grey Haven 9 and 11 / Iprobrite[4]

[21] There was a lack of proper governance, in that Realcor played the role of the property developer, the promoter of the property syndication scheme, the manager of investor funds, and the representative of MSI, the owner of the hotel. In this last role, Realcor had to negotiate the operator agreement with third parties on behalf of MSI.

[22] There is no evidence that investors were ever represented at any decision making body of Realcor.

[23] There is no evidence that there was ever an independent board of directors throughout the Realcor group of companies, nor audit, risk, and remuneration committees.

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[4] The provisions were essentially the same throughout the three disclosure documents

[24] There is no indication that the respondent had never seen a set of audited financial statements for Realcor.

[25] Investors were invited to invest their funds directly into the account of the promoter, and not into a registered trust account as Notice 459 demands. This was a direct affront to the legislative measure that is meant to protect investors. Regardless of this risk, the respondent still advised the complainant to invest.

[26] None of the debtors (the investment companies) had ever traded and had no assets. The investment companies existed for one purpose, and that is to raise funds.

[27] The respondent also failed to explain how it was possible for Realcor to pay 12% interest (much higher than market related rates); 7% commission (also much higher than markets); pay fees to Realcor (firstly as the agent of MSI, secondly, as manager of investor funds) and fund the development of the hotel. In the absence of an independent source of income, it is not clear how it was possible for Realcor to sustain these payments and pay for the development, other than from the investors own funds. This risk too eluded the respondent.

[28] There is no prospect that the complainant will recover any funds from Realcor, nor from any of its subsidiaries. Realcor was finally liquidated and the partly developed property sold in liquidation during 2011.

The Code

[29] The respondent had an agreement with the complainant in terms of which he rendered financial services to him. The specific form of financial service that the complaint is concerned with, is advice[5]. This advice had to meet the standard prescribed in the General Code of Conduct. The complainant acted on this advice.

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5 The definition of a financial service in section 1 includes an intermediary service.

[30] It is evident from the documentation provided, that the respondent did not obtain any information from the complainant for the purpose of conducting an analysis as required by section 8 (1) of the Code. The only instances in which a provider is allowed to deviate from the requirements of section 8 (1) are set out in section 8 (4) (a) and they are: (i) and (ii).

[31] It follows that there was no basis for the respondent not to conduct the required analysis in order to provide the complainant with appropriate advice. The respondent's conduct as evidenced above was a clear attempt to disregard the Code. Section 8 (1) is clear in its instruction and it says, a provider **must** prior to providing advice, take reasonable steps to seek appropriate and available information from the client, conduct an analysis and identify suitable products (own emphasis). It was therefore the respondent's duty to determine the suitability of the investment, not the complainant's and the respondent had no basis to transfer that duty to the complainant.

[32] Section 8 (2) provides that the provider **must** take reasonable steps to ensure that the client understands the advice and is in a position to make an informed decision. The documentation seems to be an attempt by the respondent to contract out of his negligent conduct.

[33] In the absence of a proper record of advice, it is not clear what made the respondent conclude that the complainant's needs could only be addressed by means of property syndication products. The information contained in this document is limited. Equally, there is no evidence that the respondent considered other types of investments with less risk than property syndications.

[34] There is further no information evidencing that the respondent was concerned with the complainant's capacity to absorb high risk. Since no risk analysis was conducted, the basis upon which the recommendation was made, is not clear. I conclude that the

respondent failed to recommend a product that were suitable to the complainant's risk profile and capacity.

[35] It seems reasonable to conclude that the respondent intended to sell the Realcor investment, whether or not the complainant's circumstances were suited to it, in violation of section 8 (1) (c) of the Code.

[36] It is improbable that the complainant would have, on his own accord, elected to make an investment in Realcor without being encouraged by the respondent.

[37] Even if the complainant wanted to invest in Realcor, as the respondent alluded, he nonetheless had a duty to state that:

37.1 Realcor had been directed by the Reserve Bank not to collect investor funds, following the inspection;

37.2 information provided in the prospectus was conclusive that investors carried all the risk; and that the prospectus undermined Notice 459;

37.3 the product was high risk and not suitable for the complainant; and

37.4 complainant could lose his capital.

[38] Had these statements been made clear, the probability of the complainant proceeding with the investments, were unlikely.

[39] I conclude that the respondent could not have appropriately apprised the complainant of the risks involved, in violation of section 7 (1) of the Code. The section calls upon providers other than direct marketers to provide (a) '*reasonable and appropriate general explanation* of *the nature and material terms of the relevant contract* or transaction to a client, *and generally make full and frank disclosure* of any information *that would reasonably be expected to enable the client to make an informed decision.*

[40] A responsible provider acting in terms of the law would have been more cautious with his client's money. By investing the complainant's funds in a high risk product, despite the complainant's personal circumstances, the respondent failed to act in the interest of his client, in violation of section 2 of the Code.

G. CAUSATION

[41] The question that has to be answered, is whether the non-compliance of a provision of the Code can give rise to legal liability, whether in contract or delict.

[42] I refer in this regard to the decision of the Appeals Board[6] in the matter of *J&G Financial Service Assurance Brokers (Pty) Ltd and another v RL Prigge*[7]. The Board noted the following:

"The liability of a provider to a client is usually based on a breach of contract. The contract requires of a provider to give advice with the appropriate degree of skill and care, i.e., not negligently. Failure to do so, i.e., giving negligent investment advice, gives rise to liability if the advice was accepted and acted upon, that it was bad advice, and that it caused loss. And in deciding what is reasonable the Court will have regard to the general level of skill and diligence possessed and exercised at the time by the members of the branch of the profession to which the practitioner belongs.3

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

In both instances the breach must be the cause of the loss....."

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6 Effective 1 April 2018, the Board is now called the Financial Sector Tribunal

7 FAB 8/2016, paragraphs 41 – 44

[43] In the matter of *Smit v Abrahams*[8] two tests were identified: the direct consequences test and the reasonable foresight test. The former was explained as follows[9]:

"The presence or absence of reasonable anticipation of damage determines the legal quality of the act as negligent or innocent. If it be thus determined to be negligent, then the question whether particular damages are recoverable depends only on the answer to the question whether they are the direct consequence of the act".

Farlam AJ pointed out in the *Smit* case that the principle upheld in the matter of *Overseas Tankship (UK) Ltd v Morts Docks & Engineering Co Ltd*[10] is subject to two qualifications. As long as the "kind of damage" is foreseeable, the extent need not be. Furthermore, the precise manner of occurrence need not be foreseeable.

[44] If the respondent had adhered to the Code, no investment would have been made in Realcor. The violations of Notice 459 and the poor governance practices meant that investors had no protection from director misconduct. Not only was the loss to investors reasonably foreseeable, it was inevitable. The investment was high risk and inappropriate for the complainant.

H. THE ORDER

[45] In the result, I make the following order:

1. The complaint is upheld.

2. The respondents are hereby ordered to pay the complainant, jointly and severally, the one paying the other to be absolved, the amount of R70 000.

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8 1992 (3) SA 158 (C)

9 See also in this regard *Foundational Principles of South African Medical Law* Carstens P and Pearmain D (2007), pages 509 – 515 in respect of causation

10 1961 AC 388 (PC); 1961 1 All ER 404

3. Interest on these amounts at a rate of 10% per annum from the date of determination to date of final payment.

4. Upon full satisfaction of this determination, complainants are to cede their rights and title to the Realcor investment to the respondents.

DATED AT PRETORIA ON THIS THE 15th of JUNE 2018.

NARESH S TULSIE

OMBUD FOR FINANCIAL SERVICES PROVIDERS