THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NUMBER: FAIS 07863/10-11/ GP1

In the matter between:

ANNA MAGRIETHA KRITZINGER	**Complainant**
and	
HUIS VAN ORANJE FINANSIËLE DIENSTE BPK	**First Respondent**
BAREND PETRUS GELDENHUYS	**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] Complainant is Anna Magrietha Kritzinger, a female pensioner whose details are on file with the Office.

[2] First respondent is Huis van Oranje Finansiële Dienste Bpk, a public company duly incorporated in terms of South African Law, registration number 1995/006025/06, with its principal place of business at 1421 Collins Avenue, Moregloed, Pretoria.

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.

[3] Second respondent is Barend Petrus Geldenhuys, an adult male representative and key individual of first respondent in terms of the FAIS Act. At all material times complainant dealt with second respondent.

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

B. FACTUAL BACKGROUND

[5] On or about 16 September 2010 complainant concluded an agreement with Iprobrite (Pty) Ltd, a public company with registration number 2009/007170/06, represented by Purple Rain Properties 15 (Pty) Ltd t/a Realcor Cape with registration number 1997/004873/07.

[6] The agreement was in connection with the purchase of shares in the amount of R55 000 in the Blaauwberg Beach Hotel, Erf 19390.

[7] 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. These companies included Midnight Storm Investments ("MSI"), which owned the Blaauwberg Beach Hotel (hereinafter, referred to as 'the hotel'), Grey Haven Riches 9 Ltd, Grey Haven Riches 11 Ltd, and Iprobrite Ltd (hereinafter, collectively referred to as "Realcor").

[8] Realcor subsidiaries raised money by issuing the investing public with one (1) year and five (5) year debentures and various classes of shares[1]. 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, 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.

[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[2].

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1 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.

2 Act No 90 of 1989

[12] Through this 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 is repaid.

[13] Iprobite was finally 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. For more details in respect of Realcor and its subsidiary companies, refer to the determination of Peens[3].

[15] At the time of concluding the investment agreement on 16 September 2010, complainant was a pensioner. The funds utilized to make the investment came from savings held in an Absa account.

[16] Complainant signed an advice record in accordance with Section 8(4) of the General Code of Conduct (the Code) at the time of concluding the agreement. I deal with this document later in this determination.

[17] Complainant states that she never received any payment in terms of the agreement. She was informed by respondent during October 2010 of the

[3] FAIS 04376-12/13 GP 1

difficulties that Realcor was experiencing, adding that interest would be paid round about February or March 2011.

C. THE COMPLAINT

[18] The basis of complainant's 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 advise complainant and disclose the risk involved in the Realcor investment.

D. RELIEF SOUGHT

[19] In complainant's own words, the relief sought is:

"We plead with you to act on our behalf against Mr F van der Walt, Mr BP Geldenhuys and Realcor Cape, together or separately so as to receive our interest due and if possible to cancel the contract and be paid back our full sum of R55 00. Mr BP Geldenhuys has signed the contract as representative of Huis van Oranje Financial Services."

E. RESPONDENT'S RESPONSE

[20] During January 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 15 March 2011. The essence of respondent's response is encapsulated in the paragraphs appearing here below:

20.1 There was compliance with the requirements of the Code in that all documentation (FICA, Record of Advice, Disclosure letters) were provided to complainant and duly signed.

20.2 Respondent visited complainant on at least three (3) occasions to determine what their needs were and explain the different products.

20.3 From respondent's perspective, the complaint is about Realcor's failure to pay the agreed interest, therefore, in respondent's view the complaint should be directed at Realcor. Respondent further states that the complaint does not refer to inappropriate behaviour on the part of respondent.

[21] Following the aforesaid response, respondent was advised in further correspondence dated 24 March 2011, to resolve the matter with his client and submit further documentation. In his reply of 30 March 2011, respondent referred the Office to his first response. Respondent maintains its view that complainant is unhappy with the conduct of Realcor, and not with respondent's conduct.

[22] On 18 April 2011 a notice in terms of Section 27(4) was issued to the respondent, to which respondent duly responded on 6 May 2011, referring to all previous documentation that he had provided. In response to questions raised in the notice, respondent stated that:

22.1 complainant had contacted him in respect of a specific product she and her husband wanted to invest in, because of the returns the product could give them;

22.2 complainant signed all the relevant documentation after the product was explained;

22.3 respondent continued to communicate with complainant in respect of Realcor's failure to make the necessary payments; and

22.4 in response to the question dealing with due diligence, respondent indicated that the company and building site were visited by their representatives at least four (4) times. The financials were inspected by the representatives and consultations were held with the auditing firm of the group. The prospectus was studied and references were checked. Consultations were also held with prospective tenants of the hotel. The group's products were also monitored to ensure that it was performing. Finally, respondent concluded that it could not be held liable for the financial problems of Realcor.

[23] A further notice in terms of Section 27 (4) was sent on 3 June 2016, advising respondent that the Office had accepted the matter for investigation and further informing respondent to provide all documents and or recordings that would support their case. The notice further indicated to respondents that in the event the complaint was upheld, respondents could face liability. No response was received to this letter.

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 (2); 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] I deem it important to first 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, complainant is objecting, amongst other matters, about respondent's failure to appropriately advise her and his continued assurance that the investment is safe.

[27] Respondent acted as an authorised representative of Realcor Cape. This much is confirmed by the contract signed between complainant and respondent[4]. As to whether respondent may be held liable for the financial services rendered whilst acting in his capacity as representative of Realcor, attention should be given to the definition of a representative[5]. The definition of a representative assumes that a person acting as a representative has to exercise the relevant final judgment,

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4 See "Adviesrekord van 'n onderlinge ooreenkoms"

5 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…

decision making and deliberate action inherent in the rendering of a financial service to a client[6].

[28] In *Moore versus Black*[7], 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 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

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

7 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

Black v Moore Appeal[8]. Appellants, relying on Board Notice 95 of 2003 argued that the responsibility lay not with the appellant as a representative but rested 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[9] 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).

It is clear that there is a duty imposed not only on 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 complainant was properly advised as required by the Code?

[31] Respondent was invited to demonstrate that he had conducted due diligence on Realcor, prior to advising his client. In his response to the notice in terms of section 27 (4) of the FAIS Act, respondent alleged that:

(i) the company and building site were visited by their representatives at least four times;

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8 Decision handed down on 14 November 2014, paragraphs 18 to 23

9 Financial Advisory and Intermediary Services Act 37 of 2002

(ii) the financials were inspected by the representatives and consultations were held with the auditing firm of the group;

(iii) the prospectus was studied and references were checked;

(iv) consultations were also held with prospective tenants of the hotel; and

(v) the group's products were also monitored to ensure that it was performing.

[32] Respondent was careful not to give away any information. He chose to be vague and failed to provide persuasive evidence. In my view, the obfuscation was deliberate so as to avoid dealing with the truth. As will become apparent, respondent conducted no due diligence whatsoever on Realcor. Indeed, had respondent read the prospectus, he would have noticed that there were no financial statements available since the company was a start-up. What respondent had access to, which he refers to as financial statements, was nothing more than a set of management accounts for a period of three months. These dealt with the issuance of debentures, shares and related costs. In any event, respondent does not state how the management accounts assisted him in concluding that the investment was sound. As for the visits to the sites, the alleged consultations with unnamed auditors of the group and the so called prospective tenants, these are empty statements that do not take the matter further and must therefore be dismissed.

[33] In order to get a better appreciation of the risks associated with property syndications and the kind of disclosures that should have been made by respondent in order to properly advise complainant, one has to refer to the statutory

disclosures contained in the Government Notice 459 published in Government Gazette 28690 in 2006, hereinafter referred to as 'the notice'.

[34] The notice contains minimum mandatory disclosures, which must be made by promoters of property syndicates. The disclosures must form part of the disclosure document or prospectus, which must be issued by the promoter. By extension, any provider who recommends this type of investment to clients, must be aware of the notice and is obliged to 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:

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."

[35] 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 the notice. It is important to mention that this was not hidden. Investors were invited to pay money into the account of Realcor. 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 event, respondent should have immediately ceased advising his clients about this investment.

[36] 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."

[37] One can easily conclude from respondent's version that he had not satisfied himself on whether the promoter of this syndication had complied with the provisions of section 3 (c) of notice 459.

[38] Perhaps, the fundamental flaw in respondent's conduct was his decision to promote this product to his clients, when he knew that he had no understanding of the product and no resources to evaluate the risk inherent therein.

[39] From the documents that were in circulation then to promote this investment there was no information whatsoever that informed respondent about any governance arrangements. There was no independent board of directors. As a start-up company respondent had no credible material on which to rely in order to evaluate the financial soundness of the entity. Respondent provides no insight into how he went about establishing information that points the entity's business model, its commercial and legal viability. It comes as no surprise that respondent did not include any documentary evidence to support his 'due diligence'.

[40] 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:

(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;'*

[41] In order to demonstrate compliance with section 8 (1), respondent provided a document entitled "Adviesrekord van 'n Onderlinge Ooreenkoms"[10]. 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.'

[42] The record of advice deals with three types of products that were considered, namely Realcor Cape, PIC and Sharemax, all three products being property syndications. There is no indication that other investment types were considered. As to why complainant's needs could only be addressed by means of property syndication products, respondent has not explained. The recommendation to invest in Realcor was on the basis that it offered the highest return. This much is noted on the advice record. There is no information evidencing that respondent was concerned by complainant's capacity to absorb high risk. Equally, there is no evidence that respondent was open to consider other types of investments with

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

less risk than property syndications. Respondent failed to meet the requirements of section 8 (1) (c).

[43] What complainant needed to know is a simple statement to the effect that she could lose her entire capital in this investment. She also needed to know that respondent had no resources to evaluate the financial soundness and legal viability of this investment. Had these two statements been made clear, the probabilities that complainant would have gone ahead with the investment are zero.

[44] It appears from this document and the surrounding circumstances of this case that respondent had taken no time to satisfy himself that complainant understood the advice in violation of section 8 (2). The provision states that a provider must take reasonable steps to ensure that the client understands the advice and is in a position to make an informed decision. On the contrary, respondent informed complainant that the investment was safe and her capital was guaranteed.

[45] 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.

Record in terms of section 8 (4) of the Code

[46] Respondent provided a document entitled “Adviesrekord ingevolge artikel 8(4) van die Algemene Kode” which translates to the Record of Advice as required in Section 8(4) of the Code.

[47] Before I examine the document further, it might be useful to refer to section 8 (4) (a). The section stipulates that where a client has not provided all the information

requested by a provider for the purposes of furnishing advice, the provider must fully inform the client and ensure that the client understands that:

(i) a full analysis could not be undertaken;

(ii) there may be limitations on the appropriateness of the advice provided; and

(iii) the client should take particular care to consider on its own whether the advice is appropriate considering the client's objectives, financial situation and particular needs.

[48] Part three of the said record of advice contains the following question and answer:

Question: Reason as to why needs analysis was not conducted?

Answer: The client did not want to provide all the necessary information, which would have enabled me to conduct a detailed needs analysis.

[49] Part four of the record advice notes the following information:

Client's financial information:

- *An analysis of the client's financial position was not conducted*
- *The client did his own analysis*

Client's risk profile:

- *The client manages his own investment portfolio*

Client's needs and objectives:

- *To earn the highest return on his investments as fast as possible*

[50] On further inspection of the document, it is evident that the above information was already inserted prior to signature thereof. The answers therefore, could not have been proper responses completed in accordance with complainant's

circumstances at the time. The only rational conclusion to be made under these circumstances it that the record does not meet the requirements of section 8 (4) (a).

[51] I am persuaded that the contents were not explained to complainant and that she was unaware of the consequences of affixing her signature to the said records. It is evident from the lack of information relevant to complainant's circumstances [in respondent's record of advice] that respondent had no intention of providing appropriate advice. In any event, respondent had no resources to advise complainant on this investment.

[52] The document is nothing more than a failed attempt to create the impression that the Code had been adhered to.

[53] That complainant wanted to make the investment in Realcor, according to respondent, does not absolve respondent from his duties in terms of the Code. Respondent still had a duty in terms of section 8 (1) (c) to identify products that would be suitable to the client's risk profile and financial needs, regardless of what complainant thought would have been in her interest.

Did respondent's conduct cause the loss complained of?

[54] Having canvassed the circumstances of this case, it is logical to conclude that the investment came into existence as a result of the respondent's advice. I have already mentioned that based on the violations of Notice 459 alone, respondent should have never recommended the product to anyone. Thus, absent the respondent's advice, there would be no investment in Realcor.

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

55.1 Respondent was not alive to the confusing and complicated structure of the investment, which had the effect of denying investors security;

55.2 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.

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

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

55.5 Respondent had no means to evaluate the financial viability of the business proposal;

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

55.7 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. Thus, respondent caused complainant's loss.

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

H. QUANTUM

[57] Complainant invested an amount of R55 000. There are no prospects of ever recovering the money from Realcor.

[58] Accordingly, an order will be made that respondents pay to complainant an amount of R55 000 plus interest.

I. ORDER

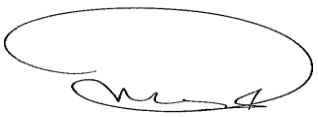
[59] In the premises, I make the following order:

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 R55 000;

3. Interest on the amount of R55 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 19th DAY OF SEPTEMBER 2016



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OMBUD FOR FINANCIAL SERVICES PROVIDERS