IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS-04997/12-13/ NW 1

FAIS-05001/12-13/ NW 1

In the matter between:

DANIEL J POTGIETER	**First Complainant**
ELIZABETH G POTGIETER	**Second Complainant**

and

JOHAN THERON MAKELAARS BK	**First Respondent**
JOHAN THERON	**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] This determination follows a recommendation made in terms of section 27 (5) (c) of the Act on 20 March 2018.

[2] The recommendation upheld the complaint of inappropriate advice and found that a sufficient link between the inappropriate advice and the loss suffered by the complainants existed. The respondent did not accept the recommendation.

B. THE PARTIES

[3] The first complainant is Mr Daniel J Potgieter, an adult male pensioner. The second complainant is Mrs Elizabeth G Potgieter, an adult female pensioner. Their particulars are on file with this Office.

[4] The first respondent is Johan Theron Makelaars BK, a close corporation duly incorporated and registered with registration number 2007/191855/23. The regulator's records confirm the first respondent's principal place of business as 154 Kock Street, Rustenburg, 0299. The first respondent is an authorised financial services provider with licence number 33930. The licence has been active since 12 March 2008.

[5] The second respondent is Johan Theron, an adult male and representative of the first respondent. The second respondent's address is the same as that of the first respondent.

[6] I refer to the first and second complainants as "the complainant", and to the first and second respondents as "the respondent". Where appropriate, I specify.

C. THE RESPONDENT'S REPLY TO THE RECOMMENDATION

[7] The respondent, through his attorney, raised a number of technical points instead of responding to the real issue at hand, being the inappropriate advice rendered by the respondent. Such arguments include lack of jurisdiction, unconstitutional practices, bias and personal attacks on employees of this Office. In all these matters, the attorney spends more resources on procedural tripwires, rather than dealing with the substance of the dispute, with reference to a factual basis for disputing the complainant's claims.

[8] The aforesaid arguments are not new to this Office and have been raised *ad nauseam* by the respondent's attorneys in other matters. In a ruling[1] of the Financial Sector Tribunal (the Tribunal) following an application for leave to approach the Tribunal, the deputy chairperson had the following to say:

"The time has unfortunately arrived to inform the instructing attorney that too many of the applications that emanate from his office are, prima facie, vexatious and amount to

[1] *Koch & Kruger Brokers and Others v DS van Rooyen and the FAIS Ombud* FAB40/2018

an abuse of process. The issues raised in this application have nearly all been raised in previous applications and appeals - unsuccessfully. The applications are on a template and more often than not deal with generalities and not with the particular facts of the case.

The application is dismissed".

[9] As for the remainder of the response, much of what is stated has already been dealt with and responded to in the recommendation. I will nonetheless deal with some of the issues again:

Complaint exceeds jurisdictional limits

[10] The respondent stated that the complainant submitted one complaint which was unlawfully "split" by this Office to help the complainants bring their complaint within the R800 000 jurisdictional limit of the Office. This statement is devoid from the truth. The complaints of the first and second complainant was split at the time into two files for administrative purposes. This did not change the fact that financial services were rendered to both the first and second complainant, on different occasions. The respondent should also be reminded that he collected 6% commission on each of the investments made.

[11] The respondent has either failed to interpret, or misinterpreted rule 4 (c) of the Rules on Proceedings of the Office of the Ombud for Financial Services Providers (the Rules), which provides that *a complaint must not constitute a monetary claim in excess of R800 000, for a particular kind of financial prejudice or damage.* Paragraph 15 of the recommendation provides a breakdown of the investments in the name of each of the complainants. Each investment represents a separate and distinct cause of action and there is no question that the Office has jurisdiction to consider the complaints.

Complaint not justiciable

[12] The respondent claimed that the complaint never became justiciable as a result of non-compliance with the Rules (4, 5 and 6), and that the allegations made by the complainants do not qualify as a complaint as defined in the FAIS Act.

[13] In respect of the first allegation, I refer to the matter of *Mostert v Landman*[2]. The respondent (represented by the same attorneys) raised this very argument, and the former Appeals Board replied as follows:

"Section 27 (4) is important and is also couched in peremptory terms in that:

'The Ombud must not proceed to investigate a complaint officially received, unless the Ombud –

(a) Has in writing informed every other interested party to the complaint of the receipt thereof;

(b) Is satisfied that all interest parties have been provided with such particulars as will enable the parties to respond thereto; and

(c) Has provided all the interested parties the opportunity to submit a response to the complaint.'

Once these provisions have been complied with, the Ombud proceeds to investigate and determine the 'officially received complaint' and in this regard the Ombud may follow and implement any procedure which the Ombud deems appropriate (section 27 (5))".

And

"………We therefore conclude that non-compliance by the complainant with rule 5 (b) does not render the lodging of a complaint a nullity, if the complaint qualifies as a complaint. With the use of the word "otherwise" in section 27 (c), the legislature intended to give discretionary powers to the Ombud and the word otherwise should not

[2] FAB 12/2017, paragraph 15 - 16

be construed in any limited sense as meaning or only referring to the condition provided for in rule 5 (b) amongst others…"

[14] It is evident from the file of papers that the respondent was properly informed of the complaints against him, by means of rule 6 (b) notices during October 2012. The respondent duly replied, but never raised any issues of non-compliance with the Rules. The respondent was also provided with notices in terms of section 27 (4) during June 2015 to which he replied on 17 September 2015, and a further notice during May 2016. If the respondent had the intention of resolving the matter, he had ample opportunity to do so.

[15] There is furthermore no justification for the statement that the allegations made by the complainants do not qualify as a complaint as defined in the FAIS Act. Not only was the respondent provided with the complaint form, but also an additional e-mail submitted by the complainants dated 17 October 2012, clarifying their complaint and their relationship with the respondent. The respondent made reference to this e-mail in his response of October 2012.

[16] The intention of the legislator could not have been to hold a lay person to such strict standards as far as form and process is concerned, that a person who has not drafted his complaint in the form of pleadings using legal jargon, may not be assisted. This would defeat the purpose of this Office. The Office is therefore satisfied that both parties had an opportunity to state their case, based on the information provided.

[17] The respondent also claimed that this Office merely chose the version of the complainant over his. This is simply not true. Just because this Office did not draw the conclusions the respondent desired, does not mean that his version or documents were ignored.

Section 27 (3) (c)

[18] The respondent submits that no cogent reason has been presented for dismissing an application in terms of section 27 (3) (c) and states that the Ombud is obliged to deal with such an application. Furthermore, the Office supposedly incorrectly quoted the Honourable Baqwa J in the *Deeb Risk*[3] matter in that the judgement is not a confirmation of the processes followed by this Office.

[19] I respectfully refer the respondent to paragraph 38 of the *Deeb Risk* judgment, which stated as follows:

"The effect of section 27(3)(c) (supra) is that first respondent retains jurisdiction over a complaint unless she, on reasonable grounds makes a determination that it should be dealt with by a court or any alternative dispute resolution process. It has been submitted and I accept that first respondent administers an institution which in terms of FAIS demands efficiency and economy and that this may indeed justify the lack of a public hearing in circumstances which may be resolved quickly and with minimal formality.

See: The Queen (on the application of Heather Moor & Edgecomb) v Financial Ombudsman Office and Lodge (2008) EWCA Civ 642 (11 June 2008)

The section confers neither a right on applicant to demand that the ombud declines her jurisdiction to deal with complaints nor does it confer a duty for her to do so. The section clearly confers a discretion on the first respondent. Any other interpretation would be tantamount to stripping her of her statutory powers in terms of FAIS Act. Absent a decision by the first respondent to refer the matter to a court, she retains jurisdiction….."

[20] It is disingenuous of the respondent to claim that this Office misquoted the judgment, when the judge specifically dealt with the inquisitorial process, as well as the applicant

[3] *DR Risk v the FAIS Ombud and Others*, case number 38971/2011, North Gauteng High Court

in the matter's interpretation of the word "may" as it is stipulated in section 27. This was a direct result of the applicant's challenge against the refusal of the Ombud in the said case to refer the matter to Court.

[21] The fact that the respondent's section 27 (3) (c) application was rejected, does not mean that it was not properly considered. That there is a dispute on how the relationship between the complainants and the respondent started, is not sufficient reason to refer the matter to Court. This Office is perfectly capable of determining which facts are relevant to establish whether there was any contravention of the Act and the Code. It has in any event not been disputed that there was relationship between the complainants and the respondent where he collected commission, and was therefore required to give advice, in line with the provisions of the Code.

Notice 459

[22] The respondent is of the view that Notice 459 did not apply to the Sharemax Zambezi and The Villa investments. There is no legal basis for this claim, and the respondent has not provided any documentary evidence to confirm that the two schemes were exempt from the application of the Notice. This Office has also not seen any representations from Sharemax to the FSP's that Notice 459 did not apply.

[23] The respondent however submits that Sharemax was governed by the provisions of sections 145, read with sections 148 to 161 of the 1973 Companies Act, and submits that the information required by the Companies Act adequately covers the requirements of the Notice.

[24] The Companies Act does not deal with the requirements of Notice 459, specifically the requirement that investors' funds have to be protected from being transferred out of the protection of a trust account. The respondent acknowledged the aforesaid, but still submitted that the prospectus complied with the "information requirements" as set out

in Notice 459. It is not clear how the aforesaid would assist prospective investors, as the objective of the notice is not only the disclosure of information, but investor protection. There is thus no legal basis to conclude that the notice did not apply.

[25] An FSP is obliged by the Code to be familiar with a product and the legality thereof, before recommending it to a client. In advising clients to invest in any property syndication, FSP's are obliged to point out that the promoter either did, or did not comply with Notice 459. Failure to do so amounts to negligent conduct. I refer in this regard to the judgments of *J & G Financial Service Assurance Brokers (PTY) Ltd and another Vs Robert Ludolf Prigge*[4] and *CS Brokers and others v James Bruce Wallace*[5].

The King Code

[26] The respondent claimed that the King Code only applied to listed entities on the JSE. Had the respondent read the report[6] further, he would noticed that it also applies to banks, <u>financial</u> and insurance entities as defined in the various legislation regulating the South African financial services sector. Being an authorised financial services provider at the time, it would have applied to Sharemax.

[27] The respondent nonetheless missed the point. The reference to the King Code was to highlight failures in corporate governance which exposed investors and shareholders to risk, as there was no independent board of directors in the entire Sharemax group, nor was there independent audit, risk and remuneration committees.

[28] For example, the directors of Zambezi Ltd (the company into which complainant's investment went), were the same as those of Zambezi Retail (Pty) Ltd, the company that would eventually own the property after transfer, and Sharemax. Sharemax also

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[4] FAB 8/2016

[5] FAB 5/2016

[6] From the King II report which would have been applicable at the time. See point 1.1.2 of the King II document.

assumed all of the following roles: promoter, company secretary, transfer secretary and manager of investor funds. Investor funds were at risk the moment it was paid into the trust account of the attorneys. The complainants should have been made aware of this.

Risk and Pacta sunt servanda

[29] The respondent relies on the fact that the complainants received prospectuses, and signed documentation (including the USSA documents) which confirms that the risks were explained to them. The allegations raised by the complainant, in the respondent's view, are therefore contradicted by the documents they signed. In this respect, the respondent raises the issue of *pacta sunt servanda*[7] and *caveat subscriptor*[8].

[30] These arguments however are misplaced. The complainants are not disputing the validity of the contracts entered into to make the investments, but rather the appropriateness of the advice that persuaded them to conclude the said contracts in the first place.

[31] A signature by an investor does not equate to an understanding of the risks in the investment, and that a person was willing to invest because they were in a position to make an informed decision. The client questionnaire dealing with the risk assessment contains a set of irrelevant questions and does not specifically inform the investor that there is a risk of losing all their funds.

[32] The test here is whether or not the respondent provided the complainants with adequate and appropriate advice wherein the considerable risks in the syndication products were explained to them. The complainants relied on the respondent's expertise in this regard. However, the respondent can only refer to the Sharemax

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7 The common law principles that agreements are binding and must be enforced.

8 Suggests that a person who signs a contractual document does by his signature assent to the contents of the document, and if the contents turn out not to be to his liking he has no one to blame but himself.

prospectuses, disclosure documents and application forms which are complex and convoluted documents.

[33] This Office maintains its position that the respondent himself did not appreciate the risks inherent in these investments. The respondent has not noted anywhere (in compliance with section 7 (1)), that he informed the complainants that, in respect of the two syndications, they would be lending their money to companies that did not own properties yet, and that the money would be lent to developers (who offered no security for the loans) to build the properties. In return for these investments, they would have a "claim", which is defined in the Sharemax prospectuses as an "*unsecured subordinated floating interest rate acknowledgement of debt made by the company in favour of the shareholder".* In other words, what the complainants acquired, are nothing other than debentures[9]. The complainants were not advised that they could lose all their capital.

[34] The respondent claims to have warned the complainants against investing in Sharemax and in particular so much money, but this is not recorded anywhere. The respondent further denied informing the complainants that the investments were safe. Instead, the respondent produced one record of advice which stated the opposite:

34.1 The complainant is guaranteed of a good interest rate (10%) in the first year.

34.2 The motivation for recommending Sharemax was that it was the preferred provider, and because of the good interest rates.

34.3 The complainant can expect capital growth.

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[9] A debenture is used by companies to borrow money, at a fixed rate of interest. The debenture is a document that either creates a debt or acknowledges it. A debenture is a certificate evidencing the fact that the company is liable to pay a specified amount with interest. Although the money raised by the debentures becomes a part of the company's capital structure, it does not become share capital.

[35] On a balance of probabilities, had the risk as described in paragraph 34 been explained to the complainants, they would not have risked their pension money in these investments.

The Sharemax model and the Experts

[36] In an attempt to discredit this Office's analysis of the Sharemax model and the expert opinions, the respondent's submission is that this Office, and in particular the assistant Ombud that drafted the recommendation, is not an expert and cannot rely on rulings made in this Office as authority. It was also pointed out that if this Office was not satisfied with the manner in which the expert evidence was presented, it could have asked for the opinions.

[37] These points have been dealt with in detail by this Office before, and considered by the former Appeals Board and the Tribunal, which is the authority relied on in various matters. There is therefore no justification for the allegations made by the respondent.

[38] However, to satisfy the respondent that this Office has considered other authority, I refer to the judgment of Daffue J, in the matter of *Oosthuizen v Castro*[10] where the following was noted:

At paragraph [54]:

"…….Mr Heystek[11] explained the potential dangers of property syndication and also made the point that insofar as the companies involved were unlisted, there was a lack of disclosure making it difficult for financial analysts to make meaningful comparisons. Accordingly, as testified to by him, a FSP "should not advise an investment in something which he is not himself able to fully understand."

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[10] 2858/2012, High Court, Free State Division

[11] Mr Magnus Heystek, an eminent business and investment journalist and investment strategist, gave expert evidence in respect of several aspects; in particular whether the conduct of defendant complied with that which could be expected of a financial advisor in the circumstances, and if not, what type of investment a reasonable financial advisor ought to have suggested in the circumstances.

[39] In paragraphs [55] to [60], the following is important:

" [55] Mr Heystek mentioned that defendant clearly did not explain the risks and pitfalls of property syndication to plaintiff. According to his experience properties are often sold at high valuations to the companies that form the vehicle for property syndications, allowing the promotors to make huge profits upfront. High marketing costs and commissions are paid, whilst the income stream from the underlying assets might be unpredictable and uncertain.

[56] In casu several financial journalists and others warned investors over a prolonged period. Defendant, having been aware of the criticism, should have either himself investigated the reliability of the investment or made enquiries from independent and reliable sources. It is amazing that defendant could think for one moment that interest could lawfully accrue from the investment from the first month. I wonder where he thought the magical origin of the income stream would derive from. No doubt, a simple investigation or even an inspection of the half-built shopping complex would have been an eye-opener. He should have realised that enormous costs would have to be incurred to complete the project…….. The half-built shopping complex could not earn any income for some time – it was obviously dependent on being completed, the signing of lease agreements and eventual and actual occupation by tenants – but the investment provided for income to be paid to investors from the start. This is apparently what defendant believed would happen. (my emphasis).

[57] I agree with Mr Heystek's testimony that all initial payments – at least until income is eventually received from tenants - would have to be paid out of funds put in by investors themselves. Investors therefore paid their or other investors' interest. There were no other sources of income during the construction phase of The Villa. The underlying property – the half-built shopping complex could not produce income on a monthly basis as investors and plaintiff in particular expected. Defendant was in breach of his fiduciary duty towards plaintiff in that he did not take reasonable steps to satisfy

himself of the safety of the Sharemax investment. I am also in agreement with Mr Heystek, accepting the ruling in 2013 of the Ombud for Financial Services, Ms Bam, that The Villa "bear uncanny characteristics to a so-called Ponzi Scheme."

[58] If the totality of the evidence is considered, defendant should have seen the red flashing lights, but not only that, he needed to heed and advise plaintiff differently. Defendant offered wrong and unsuitable advice to plaintiff, either through incompetence and/or ingenuousness and/or negligence, or for the lure of a small fortune. It is common cause that he earned a commission of R120 000.00 for an afternoon's effort. This is an enormous amount of money and not market-related. It is a well-known phenomenon that promotors in these types of schemes make use of high commissions to attract brokers and so-called financial advisors to do business………….. <u>His inexplicable, but obviously poor advice is indicative of lack of skill, care and diligence and did not commensurate with the commission received.</u> The parallels between the facts in casu and those in Durr are remarkable.

[60] Much more may be said of the defendant's actions and/or inactions, but I conclude by finding that defendant was negligent, and even dishonest, when he advised plaintiff, by placing no credence on the negative articles in the press and failing to objectively investigate the criticism. He failed to exercise the degree of skill, care and diligence which one is entitled to expect from a FSP".

[40] I also refer to the judgment of the former Appeals Board in the matter of *CS Makelaars*, paragraphs 31 – 41 where Harms J dealt with the structure of the Zambezi and Villa investment. The Board accepted that investors were paid out of their own funds and that their funds were used to make an unsecured loan to the developer.

[41] The aforesaid should settle any further arguments in respect of the Sharemax model, and the respondent's experts.

Due diligence

[42] The respondent incorrectly interprets "due diligence" to be an expert or forensic investigation found in the commercial sector. This interpretation is not correct. The Act and Code requires an FSP to act with due diligence. This is found collectively by reading sections 2, 7 and 8 of the Code, with Section 16 of the Act. "Due diligence" in law means the care that a reasonable person exercises to avoid harm to other persons, or their property. Here, the test is of a reasonable FSP. This Office did not in any way unreasonably raise the standard; it only called for the standard which is required by the Act and the Code[12].

[43] I also refer to the *Oosthuizen* matter, where the honorable judge dealt with what is required of an FSP:

At paragraph [53]:

"………according to the pleadings defendant admitted informing plaintiff that she did not have to be concerned as he had spoken to Sharemax as well as his consultant. This was not good enough. Defendant should have spoken to independent auditors, attorneys or financial analysts. He should have insisted on financial statements, such as income and expenditure accounts, cash flow analyses and a balance sheet. He should have inspected the shopping complex. If he did that, he would know that the investment could not possibly have an income stream at that stage or even in the foreseeable future". (my emphasis)

[44] It cannot be argued that the standard required from FSP's, are too high.

Section 8 (1), 8 (4) (b) and "single need"

[45] The respondent interprets section 8 (1) (c) to mean that there must a balancing of risk and need and submits that where an investors makes an informed decision to invest,

12 See the decision of the Board in Prigge; case number FAB 8/2016 at paragraph 42, as quoted in the recommendation

regardless of whether the risk of the product exceeds the risk the investor can take, that it would not be negligent of an FSP to assist the investor. The respondent is also of a view that the investments in question were "single needs", and that he complied with the provisions of section 8 (4) (a) and (b).

[46] The client's circumstances and needs, according to the Code, must be matched with the risk inherent in the product. It is therefore compulsory for an FSP to obtain appropriate and available information[13] from a client to conclude whether a product is appropriate or not. The respondent however attempted to contract out of this obligation by requesting his client to sign a document stating that he does not need an analysis.

[47] The concept of a "single need" does not exist, and is not defined in either the Code, or the FAIS Act. It is irrelevant whether a client required advice on one or more products. The respondent rendered advice, and therefore section 8 of the Code applied. In fact, the provisions of section 8 (1) is peremptory.

[48] If it is true that the complainants insisted on high income and returns after a proper discussion of the risks involved in the products and despite the fact that their risk profiles did not match the products, the respondent was obliged to comply with the provisions of section 8 (4) (b) of the Code. The respondent failed to provide such records. What the respondent presents as his record of compliance, is the USSA disclosure notice. This is a standard, complex, document that cannot be seen as a replacement for what the Code requires in terms of section 8 (4) (b).

No other product on the market

[49] The respondent indicated that there was no other product on the market that could have provided the returns sought by the complainants. No evidence that other products

[13] Noted in the Code as the client's financial situation, financial product experience and objective to enable the provider to provide appropriate advice

were considered, was provided. Furthermore, owing to their first investment in Sharemax, the complainants were convinced that this is the investment for them.

[50] That there was no other product on the market that could have provided the high returns, should have raised some red flags with the respondent. The respondent should have considered that the risks of capital loss by far outweighed the benefits of high returns.

[51] The respondent can also not rely on the fact that the complainants invested in Sharemax before. Without commenting on the appropriateness of this investment, the Clubview Centre investment was different to The Villa and Zambezi, in that it was an income earning property. The investments in The Villa and Zambezi were in unsecured floating rate claims[14]. Investors had no security for their investments.

D. FINDINGS

[52] The findings made in the recommendation letter are confirmed.

E. CAUSATION

[53] On the respondent's own version, factual causation was established. But for his advice, the complainants would not have invested in Sharemax and their capital would not have been lost.

[54] As for legal causation, this too has been established and, in this regard, I refer to my determination *in ACS Financial Management vs Coetzee*[15].

[55] I also refer to the Tribunal's decision in *J G Financial Service Assurance Brokers (Pty) Ltd and another vs Robert Prigge*[16].

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14 See also in this regard the discussion in CS Makelaars on the prospectus of Zambezi, paragraph 31 – 50

15 FAIS-00943-10/11 GP 1

16 FAB 8/2016

F. THE ORDER

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

1. The complaint is upheld.

2. The respondent is ordered to pay the complainants as follows:

   2.1 R671 000 to the first complainant

   2.2 R500 000 to the second complainant

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

4. The complainants are to cede their rights in respect of any further claims to these investments to the respondent.

5. The matter should be referred to the Financial Sector Conduct Authority (FSCA) Enforcement Department for consideration in respect of the breaches of the FAIS Act and the Code.

DATED AT PRETORIA ON THIS THE 19th OF SEPTEMBER 2018.

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NARESH S TULSIE

OMBUD FOR FINANCIAL SERVICES PROVIDERS