THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS PRETORIA

CASE NUMBER: FAIS 06294/12-13/ GP 1

In the matter between:

ELIZABETHA THERON	**First Complainant**
RICHARD ALEXANDER THERON	**Second 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, (ACT 37 OF 2002), (the Act)

A. THE PARTIES

[1] First complainant is Mrs Elizabetha Theron, a female pensioner whose details are on file at the Office.

[2] Second complainant is Mr Richard A Theron, a male pensioner whose details are on file at the Office. First and second complainant are married in community of property. The investment was made in the name of first complainant.

[3] 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, license number 687 which lapsed on 11 July 2011.

[4] Second respondent is Stephanus Johannes van der Walt, an adult male and representative of first respondent in terms of the FAIS Act. The Regulator's records indicate that third respondent is currently employed with FNB Financial Advisory (FSP 3075) with is place of business at FNB Century City Shop, 139 Canal Walk Shopping Centre, Century City, Cape Town.

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

B. FACTUAL BACKGROUND

[6] On or about 28 September 2009 complainant concluded an agreement with Grey Haven Riches 11 Ltd, a public company with registration number 2007/025464/06, represented by Purple Rain Properties 15 (Pty) Ltd t/a Realcor Cape with registration number 1997/004873/07.

[7] The agreement constituted an application to purchase shares to the value of R400 000 in the Blaauwberg Beach Hotel, Erf 19390.

About Realcor

[8] 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").

[9] Midnight Storm Investments 386 Limited[1] ("MSI"), was a public company which owned the immovable property on which the hotel was being constructed.

[10] Realcor subsidiaries raised money by issuing the investing public with one (1) year and five (5) year debentures and various classes of shares[2]. 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.

[11] 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.

[12] 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.

[13] 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

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1 Registration number 2007/01927/06

2 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.

Realcor's affairs through PriceWaterhouseCoopers ("PWC") in terms of Section 12 of the South African Reserve Bank Act[3].

[14] 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.

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

[16] 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.

[17] At the time of the conclusion of the agreement on 28 September 2009, complainants were pensioners. Complainants indicated that they read about the investment in a local magazine, "Vasbyt" where it was advertised. They duly contacted second respondent who advised complainant that it was a good, safe investment with a healthy interest rate and capital would be refunded within a year. Second respondent is alleged to have advised complainants that the hotel was an asset and that "the bricks could not be carried away"[4].

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[3] Act No 90 of 1989

[4] Translated from Afrikaans

[18] Complainant states that the monthly interest was paid until approximately October 2010 when it suddenly stopped. Complainants subsequently became aware that Realcor was experiencing financial problems and heard on the radio that the company had been liquidated, much to their dismay.

[19] Complainants further stated that after they became aware of the financial problems, respondent did not reply to their enquiries, frustrating their efforts to communicate with him.

[20] Complainants feel that they have been misled by respondent and want to be compensated for the loss they suffered. Complainants utilised money from an ABSA Investment account to make the investment. As pensioners, complainants relied on the income that was due to them in terms of the investment.

C. THE COMPLAINT

[21] From the foregoing factual background, complainant is aggrieved by the conduct of respondent. Complainants claim they trusted respondent's representations that the investment was safe and their capital guaranteed.

D. RELIEF SOUGHT

[22] Complainants seek payment of the invested amount of R400 000.

E. RESPONDENT'S RESPONSE

[23] During November 2012, 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 18 December 2012. Respondent confirmed that complainant had been a client since September 2009 when the investment was

made. Respondent further attached documentation which amongst others, included an “advice record”.

[24] On the 24th of June 2015, a notice in terms of Section 27(4) was issued to the respondent advising 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, they could face liability. Respondent duly responded on 6 July 2015, merely referring to all the previous documentation provided.

F. DETERMINATION

[25] The issues for determination are:

25.1 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

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

25.3 the amount of damage or financial prejudice.

G. LEGISLATIVE FRAMEWORK

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

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

26.2 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;

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

Whether complainant was properly advised as required by the Code

[27] Respondent was invited to demonstrate that he had conducted due diligence on Realcor, prior to advising complainant. No such evidence was presented and as will become apparent, respondent conducted no due diligence whatsoever on Realcor.

[28] Had respondent read the prospectus, he would have noticed that firstly, there were no financial statements available since the company was a start-up. What was available, 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. It is in any event not clear how the management accounts would have assisted respondent in concluding that the investment was sound.

[29] 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'.

[30] 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."

[31] 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.

[32] 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."

[33] 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.

About Realcor's / Iprobrite's offer

[34] 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:

34.1 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[5].

34.2 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 at paying amongst others, 'any professional bodies', must have set the scene for self-help on the part of those controlling investors' funds.

34.3 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 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 was not dealing with good stewards of investor funds and kept his clients' money away from this investment.

34.4 The directors of Iprobrite and Midnight have unlimited powers to borrow money[6].

34.5 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

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5 Paragraph 5.2.2 of the prospectus

6 Paragraph 9.10 page 25 of the prospectus

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[7]. 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.

34.6 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 investment companies, and has been instrumental in the procurement of Radisson Hotel, as the operator to operate and manage Radisson Blu Hotel[8]. Yet another red flag that should have dissuaded respondent from considering this as an investment.

34.7 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.

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7 See page 25 of the prospectus.

8 Para 9.13 of the prospectus

[35] 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 this prohibition, 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.

[36] 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.

[37] 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;'*

[38] In order to demonstrate compliance with section 8 (1), respondent provided a document entitled "Adviesrekord van 'n Onderlinge Ooreenkoms"[9]. 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.'

[39] 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 complainants' 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 complainants' capacity to absorb high risk. Equally, there is no evidence that respondent was open to consider other types of investments with

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

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

[40] 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 the financial soundness and legal viability of this investment. Had these two statements been made clear, the probabilities that complainants would have gone ahead with the investments are zero.

[41] 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 investments were safe and their capital guaranteed.

[42] 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.

Respondent's record of advice

[43] 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. This document was allegedly completed at the time the investment was made and is supposedly proof of compliance with the aforesaid section of the Code.

[44] Before I examine the documents 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.

[45] Part three of the record 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.

[46] 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*

[47] On further inspection of the document, it is evident that the above information was already inserted on the document prior to the signature thereof. Certain sections of the form were pre-printed and could not have been a proper response completed in accordance with complainant's circumstances at the time. The only rational conclusion to be made under these circumstances is that the record does not meet the requirements of section 8 (4) (a).

[48] The respondent failed to assess the risk capacity and profile of complainant prior to recommending the said investment. There is no relevant information relating to complainants' circumstances. How respondent was able to appreciate complainant's capacity for risk is therefore unclear.

[49] 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 their savings to make the investment. There is no evidence that respondent properly considered other investments suitable to complainants' circumstances and in particular, whether complainants would be in a position to recoup any loss they suffered. What is evident, is that respondent sold complainant the Realcor investment outside of any analysis of their needs or risk profile, in violation of section 8 (1) (c) of the Code.

[50] I am persuaded that the contents were not explained to complainant and that they were unaware of the consequences of affixing their signatures to the said records. It is evident from the lack of information relevant to complainants' 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 their investment.

[51] It cannot be accepted that the said record is a proper record of advice as envisaged by the Code. The document is nothing more than a failed attempt to create the impression that the Code had been adhered to.

[52] In conclusion, the available information seems to indicate that the funds for the investment came from “Investment Advantage”. Section 8 (1) (d) provides that where a financial product wholly, or partially replaces an existing product, that full disclosure should be made to client about the actual and potential financial implications, costs and consequences of such a replacement. There is no indication that respondent complied with this provision.

Did respondent’s conduct cause the loss complained of?

[53] Based on complainants’ version, the investment in the hotel was 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. The outcome of the Reserve Bank’s enquiry was a further reason for respondent to know that all is not well in Realcor. But for respondent’s failure to appropriately advise complainant, an investment was made into Realcor. This answers the factual cause test. The next phase deals with legal causation. The enquiry is whether, as a matter of public and legal policy, it is reasonable, fair and just to impose legal responsibility for the consequences that resulted from the conduct of respondents in giving advice that was inappropriate in terms of the Act and the Code.

[54] Had respondent done his work according to the Act and the Code, no investment in Realcor would have been made, this, bearing in mind complainants' circumstances. It is easy and convenient to impute loss to director mismanagement or other commercial causes. Complainants' loss was not caused by management failure or other commercial influences. The cause of loss was the inappropriate advice to invest in a risky product. That the risk actually materialized, for whatever reason, is not the cause of the loss. Otherwise the whole purpose of the Act and the Code will 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.

[55] 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 that the general nature of the harm suffered by complainant and the general manner of the harm occurring was reasonably foreseeable. A skilled and responsible FSP, acting according to the Act and the Code, would not have advised complainant to invest in Realcor. The loss suffered by complainant is as a result of respondents' inappropriate advice which was reasonably foreseeable by respondent. I refer in this regard to the matter of S*tandard Chartered Bank of Canada v Nedperm Bank Ltd*[10] where the Court held that:

[10] 1994 (4) SA 747 (AD)

"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."

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

56.1 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.

56.2 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 people at pensionable age, who had no access to capital, was negligent.

56.3 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.

56.4 Respondent cannot deny that at the time he advised complainant, there was no apparent means to protect investors against director misconduct or mismanagement. For this reason, respondent cannot claim that the harm was remote; it was real.

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

56.6 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.

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

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

56.9 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.

[57] 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 complainants' loss.

H. QUANTUM

[58] Complainant invested an amount of R400 000. There are no prospects of ever recovering the money from the hotel.

[59] Accordingly, an order will be made that respondents pay to complainant an amount of R400 000 plus interest.

I. ORDER

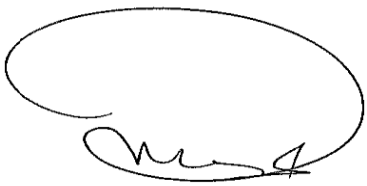
[60] In the premises, I make the following order:

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 R400 000;

3. Interest on the amount of R400 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 18th DAY OF OCTOBER 2016



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OMBUD FOR FINANCIAL SERVICES PROVIDERS