IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NO: FAIS 00949/11-12/ UN1

In the matter between:

DOUGLAS CHARLES TILLIDUFF	**Complainant**
and	
GROENELAND INSURANCE BROKERS CC	**1st Respondent**
PETRUS SWART	**2nd Respondent**

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

A. INTRODUCTION

[1] Complainant was advised by respondent to invest funds in Realcor Cape, specifically in the Blaauwberg Beach Hotel and Grabouw Industrial Park building projects, both being developments of Midnight Storm Investments 386 Ltd[1].

[1] Van Zyl and Another v Price waterhouse Coopers Incorporated and Others (12511/2013) [2014] ZAWCHC 213 (7 October 2014), Para 17

[2] The contracts pertaining to the investments were all entered into with Grey Haven Riches 9 and Grey Haven Riches 11, and the funds invested were paid into Purple Rain Properties 15 t/a Realcor Cape, as follows:

(i) R100 000 on 19 February 2008

(ii) R200 000 on 16 February 2009; and

(iii) R50 000 on 16 February 2010, making complainant's total investment into Realcor R350 000.

About Realcor

[3] Realcor was an authorised financial services provider and 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").

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

[5] Realcor subsidiaries raised money by issuing the investing public with one (1) year and five (5) year debentures, including various classes of shares[3]. In this way Realcor was able to raise substantial amounts of money from the public.

[6] The debentures and shares were marketed as attractive on the basis that investors would receive monthly interest payments and dividends before and

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2 Registration number 2007/01927/06

3 The capital structure involved a combination of a share and a debenture/loan and conversion of debentures into shares.

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.

[7] 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.

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

[9] 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.

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

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[4] Act No 90 of 1989

[11] 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.

B. PARTIES

[12] Complainant is Douglas Charles Tilliduff, an adult male whose details are on file in this Office.

[13] First Respondent is Groenland Insurance Brokers CC, a close corporation duly incorporated in terms of South African laws, with its principal place of business situated at Elgin Fruitgrowers Business Park, Main Road, Grabouw, 7160, Western Cape.

[14] Second Respondent is Petrus Swart an adult male key individual and representative of the second respondent who resides at 7 Gordon Villas, Denehof Weg, Gordon's Bay, Western Cape.

[15] The regulator's records indicate that first respondent was authorised as a financial services provider on 22 December 2004 and the license is still valid.

[16] At all material times hereto, complainant dealt with second respondent in purchasing this investment.

[17] For convenience, I refer to first and second respondents as respondent. Where appropriate I specify.

C. COMPLAINT

[18] Complainants' version of events is summarised as follows:

a) Following respondent's advice, complainant invested an amount of R100 000.00 in Realcor in February 2008. From the documents on file it appears complainant signed two application forms in relation to this amount. The first form reflects 14/02/08 as the date of signature and the second 04/11/08.

b) Subsequent to the above- mentioned investment, respondent approached complainant again and advised him to increase his initial investment. Acting on the advice, complainant invested a further R200 000.00 in February 2009.

c) During the year 2010 respondent advised complainant that he needs to "spread his risk" when investing. He again persuaded complainant to invest R50 000. What was most peculiar about this investment is that although it was introduced as a "risk equaliser" the funds were once again invested in Realcor.

d) Interest instalments payable to complainant in terms of the three investments ceased in December 2010. Complainant's attempts to recoup his capital failed.

e) It is important to note that at the time this investment was first recommended, complainant was 44 years of age, unemployed, and spent

his time preaching. From the documents provided by both parties there is no indication that complainant had other investments he could depend on.

D. RESPONDENT'S VERSION

[19] The complaint was first directed to respondent in terms of Rule 6 (b) of the Rules on Proceedings of this Office (the Rules) on 25 May 2011 with the response due on 22 June 2011.

[20] There is no response on file in respect of the abovementioned correspondence.

[21] As the complaint remained unresolved respondent was accordingly invited in terms of section 27 (4) of the FAIS Act to furnish this Office with his full version of events and supporting documents by no later than 8 November 2011.

[22] From the onset, respondent distanced himself from complainant's claim and refused to take responsibility for his advice. He stated:

"Firstly, I want to mention that the FSP in this case is Realcor Cape, and not Groenland Versekerings Makelaars. I would appreciate it if the correspondence addressed to me can be directed to them in light of the fact that the evidence should be provided by them".

[23] The rest of the respondent's response can be surmised as follows:

a) Over a period of six months' complainant decided he wanted to invest funds in Realcor Cape. Complainant's desire for the investment can be inferred from several meetings had by both parties. [*There is however, no*

record provided to this Office regarding what was discussed in the meetings with complainant because respondent did not always keep records.]

b) Respondent declared everything he knew about Realcor, with the limited knowledge he had acquired from reading the relevant prospectuses. Although he had been in the insurance industry for 18 years, he never had interest in property syndications and for that reason, did not recommend them to his clients.

c) After making his first investment, complainant decided "on his own accord" to make further investments.

E. RELIEF SOUGHT

[24] Complainant seeks payment of the invested capital amount of R350 000.

[25] The basis of complainant's claim against respondent is the latter's failure to render financial services in line with the FAIS Act and the General Code of Conduct, which includes respondent's failure to appropriately advise complainant and disclose the risk involved in this type of investment.

F. DETERMINATION

Justiciability of the complaint

[26] In terms of Rule 4 (a) a complaint is justiciable if four conditions are met, namely:

(i) the complaint falls within the ambit of the FAIS Act and the Rules;

(ii) the person against whom the complaint lies is subject to the provisions of the FAIS Act;

(iii) the conduct complained of occurred at a time when the Rules were in force; and

(iv) the person against whom the complaint lies has failed to address the complaint satisfactorily within six weeks.

[27] Having considered respondent's response, in the light of the details provided by complainant, respondent failed to address the complaint satisfactorily. With the requirements of Rule 4 (a) having been met, the complaint became justiciable.

Whether the jurisdictional requirements set out in section 27 (4) of the FAIS Act were fulfilled by this Office

[28] Respondent, through the section 27 (4) notice, was informed of the complaint and afforded sufficient time to put his case before this Office. Respondent was further warned, *inter alia*, that:

(i) this Office considers him as a respondent;

(ii) in the event the complaint was upheld, he could be held liable; and

(iii) upon receipt of his version, the Office would determine the complaint without further reference to him.

Accordingly, the jurisdictional grounds as set out in section 27 (4) of the FAIS Act have been met.

[29] The issues to be determined are:

(i) Whether respondent in advising complainant violated the FAIS Act and the General Code in any way. The specific question is whether complainant was appropriately advised prior to concluding this investment.

(ii) If it is found that respondent's conduct violated the Act and the General Code, whether such conduct caused the loss now complained of; and

(iii) Quantum.

Whether complaint is directed at the appropriate party

[31] It is appropriate that I deal with respondent's submission that this complaint is directed at Realcor. The submission is incorrect. As can be seen from the complaint, the basis of complainant's complaint is respondent's failure to appropriately advise him.

[32] I must also deal with the question whether, given respondent's claim that he was acting as Realcor's representative, it is correct that he be saddled with liability arising out of failure of this investment. To answer this question, attention should be given to the definition of a representative[5], which assumes that a person acting as a representative has to exercise the relevant final judgment; decision making and deliberate action inherent in the rendering of a financial service to a client[6].

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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…

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

[33] In *Moore versus Black*[7], the Appeal Board stated as follows;

"In effect a "representative" executes the very same act expected from a 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."

[34] The question of whether a representative [and not the provider] should be held liable, in this context, was again dealt with by the Board of Appeal in the second *Black v Moore* Appeal[8]. Appellants, relying on Board Notice 95 of 2003 argued

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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

8 Decision handed down on 12 November 2014, paragraphs 18 to 23

that the responsibility rested not with the appellant as a representative but solely with the financial services provider. In dismissing the argument, the Board concluded, *'the effect of the Exemption Notice thus allows a representative (due to his minimum experience) to market products subject to a supervisor's guidance. Apart from this exemption, he has to comply with the Code of Conduct.*'

[35] 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 on not only the provider but also the representative to comply with the provisions of the FAIS Act and Code of Conduct. The complaint is thus directed against the correct parties, one of whom is respondent.

Whether complainant had been appropriately advised

[36] Respondent was invited to demonstrate that he had conducted due diligence on Realcor, prior to advising complainant. Respondent simply indicated that he had disclosed all he knew based on his limited understanding, after reading the prospectus. I shall demonstrate that respondent conducted no due diligence on Realcor.

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

[37] In order to get a better appreciation of the risks associated with a property syndication and the kind of disclosures that should have been made in order to properly advise complainant in terms of the FAIS Act, one has to refer to the statutory disclosures contained in the Government Gazette[10], Notice 459 of 2006 (Notice 459).

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

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.”

[10] No 28690

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

"Funds shall only be withdrawn from the trust account in the event of registration of transfer of the property into the syndication vehicle; or underwriting by a disclosed underwriter with details of the underwriter; or repayment to an investor in the event of the syndication not proceeding."

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

[39] Investors' funds were paid directly into the account of Purple Rain Properties 15 (Pty) Ltd, trading as Realcor, in contravention of section 2 (b) of Notice 459. Respondent still went ahead and advised his client to invest in Realcor. In the light of this blatant disregard for the law, respondent tenders no explanation for his conduct.

[40] 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.

[41] I have not seen anything in respondent's papers that indicates that he dealt with the requirements of section 2 (d) of the Notice, given the overlapping interests

in respect of the directors of the promoter, the investment companies, and the property holding company.

[42] 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."

[43] An examination of Grey Haven Riches' prospectus shows Realcor's utter contempt for the law in so far as their duty to provide details of due diligence carried out in respect of the property. One can easily conclude from respondent's version that he had made no attempt to satisfy himself that the prospectus complied with section 3 (c) of notice 459.

[44] Although respondent was invited through the Notice in terms of section 27 (4) to provide a record demonstrating just why this investment was considered appropriate given his clients' circumstances, his response left much to be desired.

[45] Apart from a statement of his version of events and vague references to the prospectus, no records were furnished depicting complainant's financial situation at the time the financial service was rendered. To provide suitable advice, complainant's financial circumstances were pivotal[11].

[11] Section 8 (1) (a) to (c) of the General Code

[46] After thoroughly examining the offer contained in Iprobrite's, Grey Haven 9's and 11's prospectuses, I find that there was no information whatsoever which could have led any competent financial advisor to conclude that this was a sound investment.

[47] 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;'*

[48] I have already indicated that respondent furnished no information in support of the advice provided to complainant.

[49] He however, claimed complainant wanted to invest in Realcor and that he had not recommended an investment in property syndication throughout his career as a financial advisor. Predictably, respondent says nothing about the lucrative commission he received in connection with this investment, nor does he provide

documentation to demonstrate that he had dissuaded complainant from investing in Realcor as is required in section 8 (4) of the General Code.

[50] No information was submitted to this Office which shows that complainant knew what he was doing in investing in Realcor. Respondent povides no details of complainant's experience in financial products in general, and absolutely nothing in connection with complainant's investment experience.

[51] It is improbable that complainant would have, on his own accord, elected to make an investment in Realcor without being encouraged by respondent. The lack of documentation simply adds weight to the conclusion that respondent had no regard for the law and only recommended the investment in Realcor for his own gain.

[52] It should be remembered that all of complainant's investments were made after the Reserve Bank had ordered Realcor not to collect any further funds from the public. Notwithstanding, Realcor continued to collect funds from investors aided by the likes of respondent.

[53] A responsible provider acting in terms of the law would have been candid with complainant and advised his client that they are precluded by law from merely acting as a conduit between complainant and Realcor. By investing complainant's funds in a high risk investment vehicle, despite complainant's personal circumstances, respondent failed to act in his client's interests, as required by section 2 of the General Code.

[54] I reject respondent's version as improbable. Complainant has no history that shows he could of his own bet invested in Realcor. Complainant had no steady income and no other investments to his name. It is improbable that he would have gone to Realcor had respondent not persuaded him about the safety of his capital. I find that contrary to respondent's claims, he recommended an unsuitable investment to complainant.

G. CAUSATION

[55] On the cumulative information before this Office, the investment in the Realcor was as a result of the respondent's advice. This means, had it not been for respondent's advice, complainant would not have made the investment in Realcor. This answers the test for factual causation.

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

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

[58] Given that respondent had carried out no due diligence on the Realcor group, it was negligent of respondent to advise complainant on this investment. Respondent had no resources to assess the merits of this investment. On this

basis alone, he should not have advised any client on this investment. That respondent could not see the glaring violations of the law from the prospectus is sufficient to conclude that respondent was out of his depth and should have kept his distance from this investment. Thus, a skilled and responsible FSP, acting according to the Act and the Code, would not have advised complainant to invest in Realcor.

[59] Had respondent done his work according to the Act and the Code, no investment in Realcor would have been made, bearing in mind that respondent could not comply with the requirements of section 8 (1) (c) owing to his lack of understanding of the Realcor product. It is easy and convenient to impute loss to director mismanagement or other commercial causes. In this case however, complainants' loss was not caused by management failure at Realcor but respondent's inappropriate advice. That the risk actually materialized, for whatever reason, is not important. Otherwise the whole purpose of the Act and the Code would be defeated. Every FSP can ignore the Act and Code in providing services to their clients and hope that the investment does not fail. Then when the risk materializes and loss occurs they can hide behind unforeseeable conduct on the part of product providers. This will defeat the provisions of the Act and Code.

[60] The loss suffered by complainants as a result of respondents' inappropriate advice was reasonably foreseeable by respondent. I refer in this regard to S*tandard Chartered Bank of Canada v Nedperm Bank Ltd*[12] where the Court held that:

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[12] 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.”

[61] Information at this Office’s disposal points to the following conclusions:

61.1 Respondent had no ability to assess the risk in this investment, yet he advised to invest in Realcor.

61.2 Whilst respondent has argued he had not been the one who advised complainant to invest in Realcor, I have already dismissed this as improbable.

61.3 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.

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

61.5 Had the respondent followed the law, first by satisfying himself of complainant’s risk profile and conducting due diligence on Realcor, he would have understood that the investment was unsafe and posed a risk complainant had no capacity to absorb.

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

H. QUANTUM

[62] Complainant invested R 350 000.00 in Realcor.

Accordingly, an order will be made that respondent pay the amount of R 350 000.00 plus interest**.**

I. FINDINGS

[63] Based on the facts before me I make the following findings:

63.1 Respondent failed to adhere to the provisions of section of the General Code.

63.2 Since respondent had failed to conduct due diligence, he had no appreciation of the risks involved in the Realcor offer and could therefore, not have been in a position to advise complainant.

63.3 Respondent failed to acquaint himself with the regulations pertaining to property syndication environments. He could not see that the prospectus issued by Realcor violated Notice 459.

63.4 Respondent was also not frank with his client in that he did not disclose his limitations in terms of appreciating the risk involved in the product.

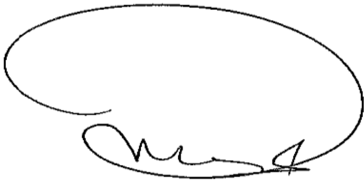
63.5 In light of the above, it is plain that respondent's conduct caused the complaint's financial loss.

J. ORDER

[64] In the premises, the following order is made:

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 R350 000;
3. Interest at a rate of 10, 25 %, from a date seven (7) days from date of this order to date of final payment.

DATED AT PRETORIA ON THIS THE 12th DAY OF DECEMBER 2016.



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OMBUD FOR FINANCIAL SERVICES PROVIDERS