IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NUMBER: FAIS 03406/12-13/ EC 1

FAIS 03408/12-13/ EC 1

FAIS 03409/12-13/ EC 1

FAIS 03410/12-13/ EC 1

FAIS 03411/12-13/ EC 1

In the matter between:

Mr Bernardus Rudolf Vorster	**First Complainant**
Mrs Magdalena Josina Vorster	**Second Complainant**

and

Fanie Du Preez Makelaars CC t/a The Meadow Group	**First Respondent**
Mr Stephanus (Fanie) Johannes Du Preez	**Second Respondent**

DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT NO 37 OF 2002 (the Act)

A. INTRODUCTION

[1] This determination follows a recommendation made in terms of section 27 (5) (c) of the Act on 17 August 2017. Section 27 (5) (c) empowers the Ombud to make a

recommendation in order to resolve a complaint speedily by conciliation**.** The recommendation is attached hereto marked Annexure (A) and is to be read together with this determination.

[2] The respondent's reasons for not accepting the recommendation are dealt with in the paragraphs following below.

B. THE PARTIES

[3] First complainant is Mr Bernardus Rudolf Vorster, an adult male pensioner whose full particulars are on file with this Office. Second complainant is Mrs Magdalena Josina Vorster an adult female pensioner whose full particulars are on file with this Office. First and second complainant are married to one another. I use complainant/s in this recommendation interchangeably.

[4] First respondent is Fanie Du Preez Makelaars CC t/a The Meadow Group, a close corporation duly incorporated in terms of South African law, with registration number (1995/039060/23). The first respondent is an authorised financial services provider, (license number 15422) with its principal place of business noted in the Regulator's records as 73 6th Avenue, Newton Park, Port Elizabeth, 6001. The license has been active since 26 November 2004.

[5] Second respondent is Stephanus (Fanie) Johannes Du Preez, an adult male, key individual and representative of the first respondent. The Regulator's records confirm his address to be the same as that of first respondent. At all times material hereto, second respondent rendered financial services to the complainant.

[6] I refer to the respondents collectively as “respondent”. Where appropriate, I specify which respondent is being referred to.

C. RESPONDENT’S REPLY TO THE RECOMMENDATION

[7] A large part of respondent’s response was directed at criticising the Office for failing to take into account his 2012 application in terms of section 27 (3) (c); his response of 2015; and his supporting documents. On that basis, respondent contended that the Ombud was not treating him fairly.

[8] This Office had taken all of respondent’s responses into account, including those he complained of. With regard to the application in terms of section 27 (3) (c), the document appears to be a cut and paste from previous responses prepared by the same set of attorneys.

[9] Respondent’s application in terms of section 27 (3) sought the following orders:

9.1 That the Ombud determine that it is more appropriate for a court of law deal with this matter and;

9.2 The Ombud decline to entertain the complaint. In the event the Ombud decided to entertain the matter, that the respondents be afforded a trial for the following reasons:

9.2.1 There are obvious discrepancies and disputes between respondent’s version and that of the complainants’ because, in respondent’s view, ‘*this structured dispute cannot be determined on*

unattested and untested versions of events'. Respondents wanted a trial.

9.2.2 The Ombud appears to correspond directly with the media and negative views had been expressed about Sharemax in the media, claimed the respondents. Respondents fear that the Ombud is no longer independent as required by section 20 (4).

9.2.3 It is respondent's constitutional right to have this dispute determined by a court of law.

9.2.4 The lack of transparency and the process followed by the Ombud meant that the respondents would not be treated fairly.

9.2.5 Respondents further raised the question whether the Ombud is a forum or tribunal.

9.2.6 A point was also made about the independence and impartiality of the Ombud given that the FAIS Ombud is part of the structure of the FSB and that appeals of a decision of the Ombud lie with the FSB Appeals Board.

9.2.7 The FSB had investigated Sharemax, claimed the respondents, and there was likelihood that the Ombud may have access to the FSB report and use it in the process of determining this complaint.

9.2.8 Respondents were also concerned that given the power of the FSB to appoint and dismiss the Ombud, the Ombud would not want to differ from views held by the FSB on Sharemax.

[10] Apart from the repetitive nature of the points raised, respondents do not make any case at all. These claims are not backed by fact; only unreasonable suspicion and hollow attack. Besides, on a proper interpretation of section 27 (3) (c), as pronounced by the High Court in the *Deeb Risk*[1] matter,the Ombud exercises discretion in each case. Absent a decision referring the matter to court, the Office retains its jurisdiction. The application is refused.

[11] With regard to the findings in the recommendation, the respondent made bold statements to the effect that the complainants are still receiving income from the investment in PIC. This, notwithstanding complainants' statement that their income stopped a long time ago. To substantiate his claim, respondent merely made reference to the ongoing litigation against PIC. He claimed that the litigation confirms that PIC, as promoter, is bound by the 'buy back agreement', in terms of which it must refund the capital to all the investors, including the complainants.

[12] With regard to the Sharemax investments, respondent refers to the section 311 Scheme of Arrangements and suggested that complainants would have been issued debenture certificates and provided with a date by which Nova Property Holdings Limited, (Nova) would pay their historical capital. Respondent referred specifically to Theresa Park, claiming that the syndication has already received back all its capital and that complainants will receive their capital in 2018. The respondent provides no document to substantiate his claims. There can be no

[1] Gauteng High Court Division, case number 50027/2014

doubt that complainants' capital is lost and as a result, they have suffered financial prejudice.

[13] In response to references made in the recommendation with regards to respondent not having been licensed when the investment into PIC was made, including some of the Sharemax syndications, respondent stated that at all times, he acted as an authorized representative of PIC and as an agent of Unlisted Securities South Africa (USSA) (Pty) Ltd, trading as FSP Network (Pty). In that regard, respondent suggested that he complied with the provisions of the FAIS Act by having been a registered Section 13 representative.

[14] Respondent rejected the notion that complainants did not have the capacity to absorb risk and that they required their capital to be guaranteed. In this vein, respondent made reference to documentation signed by complainants in which they confirm the disclosures made and the acceptance thereof. Respondent concluded that such evidence contradicts the conclusions reached in the recommendation.

[15] The prospectuses of each investment were provided and explained to complainants, the contents of which make clear reference to the risks involved and the fact that the capital was not guaranteed, stated respondent. Complainants were informed in writing that the investments were capital risk investments which were illiquid and that complainants could lose their entire capital.

[16] Respondent reiterated his claims that there were material disputes of fact as the documents referred to clearly spell out the risks inherent in the investment, the lack

of liquidity, commission's payable and the structure of the investment. Respondent as a result maintains the view that this Office is not an appropriate forum to adjudicate on this matter.

[17] Respondent referred to the opinions of experts, namely, Mike Schusller, Derek Cohen and Anton Bosman Swanepoel and claimed that the Ombud had ignored their opinions. In so doing, respondent pointed that the Ombud had conducted no investigation into the various aspects surrounding the Sale of Business Agreement (SBA) and how interest was generated in respect of investors. I deal with the opinions later in this determination.

D. DETERMINATION

[18] It is concerning to note that, despite overwhelming evidence provided in the recommendation letter, which included a summary of the relevant prospectuses which pointed to the provisions that conveyed the directors' disregard for the law and their intentions to pay investor funds well before transfer (all of which made a compelling case against recommending this product), the respondent still believes that the standard documents he submitted (including the prospectus) assist his case in stating that he disclosed the risk to his clients. What respondent deliberately avoids to answer is what made these products appropriate given his client's circumstances, and why he failed to comply with the Code in respect of section 8 (4) (b). That case remained unanswered. It is further evident that the respondent had no appreciation of the risks, in respect of the investments, for him to have properly advised his clients. Examples of the risks were adequately set out in the

recommendation letter and will not be replicated in this determination. In short, the findings made in the recommendation were left undisturbed.

The experts' opinions:

Mike Schussler

[19] The opinion from Mr Schussler, as related by the second respondent, is not helpful to the latter; in fact, it specifically recommends against an investment of this nature by complainants, bearing in mind complainants circumstances. I add that no record has been produced by respondents to this office from which it could be inferred that complainants' circumstances, objectively judged, were suited to this type of investment.

[20] Schussler classifies the risk in Sharemax as high. However, he expresses the view that this high risk is made clear in the prospectus. The suggestion is that on reading the prospectus, the potential investor will come to understand that this was a high-risk investment.

[21] Schussler recommends that no more than 5 % to 20% of their capital be invested by clients. Schussler does not appear to have applied his mind to the financial profiles of the complainants. If he did, he would have advised against any investment in Sharemax. Schussler finds Sharemax in particular to be high risk because it was not a listed company, had no trading history and the promised returns were from developments that did not exist.

[22] Schussler's opinion does not assist the respondent in so far as the question of appropriateness of the latter's advice to complainants is concerned.

Derek Cohen

[23] Cohen confirms that he came to his opinion based on the prospectus supplied to him by respondents. He did not have a copy of the SBA with Capicol which was never attached, nor was he told about the 3% commission paid to Brandberg as "agent's fees". If he was in possession of this information, he might have come to a different conclusion. Nor did he have sight of any audited financial statements. Incidentally, none of the experts considered Sharemax's audited financial statements; they did not even call for it. Nor, for that matter, did the respondents. Cohen also did not consider that the Villa and Zambezi were not existing developments but were still to be developed, during which time handsome interest payments were being promised to investors. He did not apply his mind to the fact that investors' interest payments, commissions and administration fees were being paid out of investors' funds.

[24] The model of the Villa, as explained by Cohen, is flawed and entirely unhelpful in that:

a) he did not see the SBA with Capicol, which is mentioned in the Prospectus, but was excluded from the attachments by Sharemax;

b) he did not confirm how and from what funds Capicol was going to pay the promoter 14% interest. He did not see that Capicol could only have paid this interest from investor funds being loaned to it; and,

c) he notes that investors were protected by registration of a mortgage bond. But does not see that the amount of the bond is disproportionate to the value of the property. The promised mall was never built and the bond was never registered. There was no investor protection.

[25] Even Cohen relies only on the prospectus to conclude that it is clear on the type of "investment instruments it offers". That is not the test here. The question is, was the advice appropriate, taking into account the complainant's circumstances; and; could the complainants make an informed decision about the investment?

[26] An observation to be made is that Cohen, as well as the other experts, did not apply their minds as to why Sharemax collapsed so suddenly and spectacularly to the point where nothing remained for the benefit of investors. This would not happen if the business model was as sound as the experts, as well as respondents, suggest.

[27] Cohen's opinion, as related by second respondent, is unhelpful.

Swanepoel's Opinion

[28] Respondents filed an opinion dated 14 September 2017 from this expert.

[29] The following are the main features of the opinion:

This expert offered his opinion about the duty and role of an FSP in relation to the Sharemax investment. He first correctly points out that FSPs will act professionally if they acquaint themselves with the prospectus. However, he states that they are not expected to subject the prospectus to "a searching analysis to seek for and find discrepancies" nor are they expected to challenge the opinions of professional people that appear in the prospectus. The expert also delves into the question of "due diligence". He unnecessarily researches the meaning of due diligence and finds that this is not what one expects of an FSP.

[30] It is here that I differ; it is not good enough for an FSP to merely acquaint themselves with the prospectus, nor are they expected to accept everything they read in it. An FSP is has a duty to understand the prospectus in order to properly advise their clients or to responsibly market the underlying product. The fact that the prospectus was registered and the provider was licensed by the FSB do not relieve the FSP of the duty to satisfy himself that the product is appropriate for his clients.

[31] Swanepoel, in dealing with the Villa (also Zambezi) prospectuses states the following:

a) These investments were different from other Sharemax investments in that in this case, the shopping mall did not exist (it was still being built) and the promoters and Syndication vehicle did not have any trading history.

If this is the case, a prudent FSP will want to know how and from what source did Sharemax pay high interest rates, within a month of investing,

and how commission was paid to FSPs within two weeks of making the investment. A reasonable FSP will want to satisfy himself that the interest and commissions were not being paid out of the investors own funds.

b) The prospectus promised that invested funds will be held in an attorneys trust account, as contemplated in Notice 459. However, this is then promptly contradicted in the same prospectus, where it provides that the funds will be paid out of a trust to the developer as a loan. Swanepoel saw this contradiction and tried, in vain, to explain it. He explained it as follows:

> *"Firstly, according to the director of Sharemax, one Johannes Botha, it was a question of uncritically copying from an old prospectus to the new series of The Villa and Zambezi prospectuses. Secondly, Notice 459 did not prohibit schemes where funds were to be paid prior to the transfer only prescribing the minimum information to be included in prospectuses that fell within the parameters contemplated by the Notice. The Villa scheme fell outside those parameters and therefore the Notice had to be adapted to the actual scheme and this was done accordingly. "*

c) First, Swanepoel does not state why The Villa (Zambezi) did not fall within the parameters of the Notice and which property syndication schemes would ordinarily not fall within the parameters of the Notice. Secondly, seeing the difficulty in this type of argument, (perhaps in the face of the clear wording of the Notice) he then swiftly concludes that the Notice had to be

adapted to the schemes. In so doing, this expert closes his mind to the fundamental intention behind the notice, that of consumer protection against unfair or unscrupulous business practices; this is apparent from the preamble and the peremptory language used in the Notice. In the absence of an application to the Minister to exempt the Villa from complying with the Notice, the Notice applies. The legal advice that the notice does not apply to the Villa was simply wrong. See *Picvest Investments (Pty) Ltd v The Registrar of Financial Services and The Chairperson of the Appeal Board of the Financial Services Board.* The law is clear as stated in Notice 459. The law does not call for it to be "adapted". Swanepoel's explanation lacks credibility.

d) I reject the opinion that there was compliance. The prospectuses in Villa as well as Zambezi, did not comply with notice 459. A prudent FSP, acting diligently, would have realized that there was no protection for the investors.

e) Swanepoel had to explain how the extravagant interest rates were to be paid. To put the issue into perspective, he had to explain that these payments did not come from the investors' own funds. The opinion achieved the opposite and indeed, on Swanepoel's own explanation, these payments were made from the investors' own funds. He explains that the funds first accumulated interest in the attorney's trust account in terms of section 78 (2A) of the Attorneys Act, and thereafter from interest paid by the developer to the promoter, who then paid the money to the attorneys, who in turn paid the investors their monthly interest.

This explanation is not supported by any facts. I have previously pointed out that the funds were paid out almost immediately from the attorneys account, not remaining there long enough to earn any meaningful interest. The Sharemax application form itself made provision for the funds to be paid out within ten (10) days, to fund amongst others, commission. Besides it is not disputed that, at the time, an attorney's trust account with a commercial bank did not earn anything close to 12%.

The expert's suggestion that the developer paid interest through the attorneys trust account is false and Swanepoel does not support this with any facts. It is undisputed that investors did not receive their monthly interest payments from an attorney's trust account.

f) There is a fundamental weakness in this expert's explanation. He admits that the funds were lent to the developer to fund the building. It is no longer in dispute that the investors' funds were not held in trust but were used to fund the building of the mall. It is equally undisputed that the monthly interest was paid by the developer, Capicol. What is missing from the opinion is an explanation as to how, and from what resources, Capicol made these onerous payments on a monthly basis. The answer is obvious, they made the payments from the investors own funds. This easily explains why the whole scheme collapsed once the Reserve Bank intervened. The base of new investors shrank and there was no cash to continue.

g) Much of this opinion is based on the fact that all was revealed in the prospectus and assumes that the investor read and understood this in making a decision to invest. Key to the scheme was the agreement between Sharemax and Capicol. This is described as a “Sale of Business Agreement” (SBA) in the prospectus. The prospectus also states that a copy of the agreement is annexed. This is an important annexure which investors had to read. This Office knows of no prospectus that actually had such an annexure; nor was the business agreement attached or made available to investors in any other way. Swanepoel himself mentions nothing about having access to the SBA.

h) A further glaring omission in the opinion is Swanepoel’s failure to deal with the payment of 3% “agent’s commission” to Brandberg. It is an undisputed fact that after the funds left the trust account, 3% (of 2.9 billion rand in respect of The Villa; of R900 million in respect of Zambezi) was paid from the investors’ funds to an entity called Brandberg, in terms of the SBA.

I note that, in his opinion, Swanepoel chose to account for only 6 % (in terms of money deducted from investors’ funds) but the provision made in both the application form and the prospectus is for the deduction of marketing fees of 10% (of which 6 % accounted for commission). That Swanepoel chose not to deal with the full 10% and completely ignores the additional 3% that was siphoned off, discredits his opinion that Sharemax was a sustainable and credible investment until the Reserve Bank intervened.

i) Swanepoel correctly concedes that there are FSPs out there who, upon reading the prospectus, will be unconvinced that the Sharemax scheme was viable or even legal. But he opines that there will be those FSPs who believed that the scheme, “in given circumstances”, was appropriate as an investment vehicle. What Swanepoel conveniently steers clear off are the personal circumstances and risk profile of a prospective investor (section 8 (1) of the Code). Swanepoel says nothing about the risk profiles of the complainants. He offers no opinion on the suitability of this product to pensioners investing their retirement funds. This is a substantial flaw in this opinion.

j) In writing his opinion, Swanepoel does not appear to have called for the respondents’ record of advice. Swanepoel merely relies on the Sharemax designed questionnaire accompanying the prospectus. I have previously pointed out that this questionnaire is misleading and does not serve the purpose of making a proper assessment of each individual investor’s tolerance for risk. Even if one accepts the expert’s opinion that a record of advice comprises a series of documents to be read cumulatively, there is no record that respondents, as FSPs, independently advised complainants that their capital was at risk as their funds were going to be lent to a builder and will not be kept in trust as demanded by the law. There is also no record dealing with the 3% paid to Brandberg in the light of the risk that this payment spelt for investors.

k) It was unacceptable for Swanepoel to fail to deal with the general risk profiles of the people who invested in Sharemax. He must have known that the majority of investors were pensioners and retirees. He makes no comment about the suitability of this product for people who had no tolerance for risk and had no prospect of replacing lost capital. This is a fundamental flaw in this opinion.

l) In this opinion Swanepoel places the onus squarely on the investor to read and understand the prospectus. Having stated as much he goes on to say that a signature from the investor certifying that they read and understood the prospectus suffices as proof that they were aware of the risks and made an informed decision. This is entirely unhelpful as respondents, on their own version, could not see that the prospectuses of the Villa and Zambezi violated Notice 459. Respondents claimed that the prospectuses actually complied with the provisions of Notice 459. Complainants are unequivocal; if they were told about the risks, they would not have invested. On his own version, respondent can still not explain where the return that was paid to investors came from; this, given the myriad of charges against investors' funds, long before the funds even reached the developer.

m) Swanepoel concludes that a "reasonable FSP" would not have suspected that the Villa scheme was a Ponzi scheme and could not have reasonably foreseen that the scheme will collapse due to intervention of the Reserve Bank for "highly technical reasons". Swanepoel bases his opinion on a notional "reasonable FSP". The approach is flawed as the issue here is

whether or not the respondents' advice was appropriate given the complainants' circumstances. Most importantly, the question is: why was this product considered suitable for Complainants who were pensioners with no tolerance for risk? These questions went unanswered.

I was not persuaded by Swanepoel's opinion.

[32] As evidenced in the recommendation, the respondent failed to appropriately advise complainants. In addition, no evidence is offered in support of his duty to provide advice that is suitable to the clients' circumstances and risk profile (section 8 (1) (a) to (c) of the Code).

[33] The complainants alleged that as a result of respondent's failure to suitably advise them, they have lost their capital and asked that the respondent be ordered to repay them the full capital invested in both the Sharemax and PIC schemes. In making their case, complainants alleged that the respondent had failed to disclose the risk involved in the investments.

[34] It is important to note that even in his response to the recommendation, respondent still failed to provide his records in terms of section 3 (2) and section 9 of the Code. He argued that the prospectus and the standard documents (both of which contain no reference to the risks canvassed in the recommendation) should be accepted as his records of advice. He claims that the prospectus was discussed with the complainants and the standard documents confirm complainants' acceptance that the material issues, including risk, were discussed with the complainants.

34.1 First, neither the prospectus, the respondent's record of advice, nor the standard documents deal with the violations of Notice 459, including the implications of such violations for investor security

34.2 Second, the prospectus although, it introduces the SBA, provides no detail about the SBA and most certainly, made no attempt to draw investors' attention to the risks posed by, amongst others, the payments made to Brandberg which made no business sense.

[35] Even in his response, respondent still denies that these products were high risk.

Respondents acted as representatives of USSA

[36] Respondents states that in rendering financial services to complainant, they acted as agents of USSA and as authorized representative of PIC. The Appeals Board rejected this defense in *Black v Moore*[2] and concluded that:

"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.

[2] 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

…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."

The section 311 Scheme of Arrangements

[37] Respondents referred to the section 311 Scheme of Arrangements where they state that complainants had been furnished with debenture certificates by Nova coupled with a date for payment of their historical capital. Respondent refers specifically to Theresa Park, claiming that the syndication has already received back all its capital and that complainants will receive their capital back during 2018. Respondent also refers to ongoing litigation against PIC which, respondent claims, confirms that PIC as promoter is bound by the 'buy back agreement'. Respondent however does not point to any legally enforceable instrument that guarantees complainants' capital. There can be no doubt that complainants have lost their capital. In any event, the Board in the *Siegriest* and *Bekker* appeals (FAIS

00039/11-12/GP1 and FAIS 06661/10-11/ WC 1) ruled that the investors' claims had not been compromised.

E. CAUSATION

[38] It is not sufficient to merely point to the violations of the Code without dealing with the question of whether such violations caused the loss. The recommendation dealt extensively with the risk involved in the Sharemax and PIC products, risks which respondent still refuses to acknowledge. As a result of respondent's failure to disclose the true nature of the risk involved, complainants accepted respondent's advice and made the investments. Respondent knew that the complainants were reliant on him for advice.

[39] The loss in this case was foreseeable for the following reasons:

39.1 The violations of Notice 459 alone were sufficient basis for respondent to raise serious questions about investor protection. There is no evidence that he did. Instead respondent makes reference to these very violations as evidence of the soundness of the Sharemax investment.

39.2 The conflicting provisions of the prospectus and the payment of money to entities like Brandberg, all of which do not appear to have aroused any suspicion or questions regarding the protection of investors on the part of respondent.

[40] Respondent's conduct breached the very contract he had with the complainants and the Code, which amounts to a breach of the Code[3].

[41] Respondent's failure to appropriately advise complainant caused the loss.

F. THE ORDER

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

1. The complaint is upheld.
2. The respondents are ordered, jointly and severally, the one paying the other to be absolved, to pay the complainants the amount of R160 000;
3. Interest on this amount at a rate of 10.25% per annum from the date of determination to date of final payment.
4. Complainants to cede their rights and title in respect of any further claims in respect of these investments to respondent.

DATED AT PRETORIA ON THIS THE 15th DAY OF DECEMBER 2017.

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NOLUNTU N BAM
OMBUD FOR FINANCIAL SERVICES PROVIDERS

[3] J & G Financial Services Assurance Brokers (Pty) Ltd &O v Dr Robert Ludolf Prigge Case No FAB 8/2016 – para 43 to 44