FAISOmbud
Office of the Ombud for Financial Services Providers

OUR REFERENCE: FAIS 03613-12/13 WC 1

FAIS 03614-12/13 WC 1

8 August 2017

MR RJ NEL

R & M Advisors

Per email: rmadviseurs@telkomsa.net

Dear Mr Nel

GJ & ME GROENEWALD (complainants) V ROELOF JOHANNES NEL (respondent)

RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT (37 of 2002)

A. INTRODUCTION

1. During July 2012, complainants filed a complaint with the Office against respondent. The complaint arose from failed investments that were made by complainants during June 2006 on advice of respondent. Complainants invested in the Flextronics income plan promoted by Bluezone Property Investments (Pty) Ltd[1] (Bluezone), a Financial Services Provider (FSP). The property company was noted as Tropical Paradise Trading 334 (Pty) Ltd[2], and the holding company, Liberty Lane Trading 98 Limited[3].

2. Respondent marketed the Bluezone investment as a representative of Bluezone, in terms of Section 13 of the FAIS Act. Respondent submitted documentation confirming his appointment on 21 February 2006 as a representative of Bluezone[4].

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1 Registration number 2005/00831/07

2 Registration number 2005/ 015144 / 07

3 Registration number 2006/010908/06

4 On 23 September 2008, a further certificate of authorization was issued to respondent, indicating that from that point onwards, Bluezone had to the licence to sell category 1.10 products.

Sussex Office Park, c/o Lynnwood and Sussex Avenue, Lynnwood, 0081
P O Box 74571, Lynnwood Ridge, 0040
Phone: (012) 762 5000 / (012) 470 9080; Fax: (012) 348 3447 / (012) 470 9097
www.faisombud.co.za

3. At the time that respondent rendered advice to complainant during May 2006, Bluezone itself did not have a category 1.10 license that was necessary to market debentures.

4. The training manual for Bluezone investments confirmed that it was indeed selling debentures[5]; therefore requiring a category 1.10 license. Despite having no such license, Bluezone appointed brokers in terms of section 13 to market their product violating the provisions of the FAIS Act.

5. It is a well published fact that the Bluezone scheme has since collapsed and left most of its investors with losses.

B. THE PARTIES

6. Complainants Guillaume Johannes Groenewald and Maria Elizabeth Groenewald are married to one another and were pensioners at the time of advice. Their full details are on file in this Office.

7. Respondent is Roelof Johannes Nel, an adult male and sole proprietor who trades under the name and style of R & M Advisors. Respondent's business address is noted in the regulator's records as 4B Bella Casa, Mascador Street 14, Mosselbay, 6506. Respondent is an authorized FSP as provided for in the FAIS Act, with license number 6965. The license has been in force since 11 October 2005.

8. At all material times, respondent rendered financial services to complainants.

Delays in finalising this complaint

9. I find it important to address the delay in finalising this complaint. Sometime in September 2011, just after the Office had issued the *Barnes* determination[6], the respondent in that matter brought an urgent application to set aside the determination[7]. Before the fate of the application was known, respondents sought an undertaking from this Office that it would not proceed to determine any other property syndication related complaints involving them.

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5 See paragraph 7.1, number 5

6 See E Barnes v D Risk Insurance Consultants FAIS-06793-10/11 GP 1

7 Respondent claimed that section 27 of the FAIS Act was unconstitutional

10. Since no legal basis existed for respondent's demands, the Office proceeded to determine further property related complaints involving the respondents. In reply, respondents launched an urgent application for an interdict to stop the Office from filing the determinations in court until the main application had been disposed of. The decision on the main application was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[8].

11. Following the decision of the High Court, which essentially dismissed the respondent's application, the Office continued to determine complaints involving property syndications. However, in 2013 following the *Siegrist* and *Bekker* determinations[9] and the relevant appeal, a decision was taken by the Office to halt processing property syndication related complaints. The decision was not taken lightly, but was a necessary precautionary risk management step as the Office sought to hold the directors of property syndication schemes liable for complainants' losses. The said appeal was finally decided in April 2015[10], after which the Office resumed (with due regard to the decision) processing complaints involving property syndications. As many as 2000 (mainly property syndication related) complaints had to be shelved pending the decision of the Appeals Board.

C. THE COMPLAINT

12. There is a dispute with regards to how complainant and respondent's relationship started. That being said, complainants, now 84 and 78 years respectively, have difficulty recalling the exact details of their engagement with respondent. The commonalities in both versions though, point to a meeting between complainants and respondent (during May 2006) to discuss a possible investment. At the time, complainants had an Absa investment in the amount of R1.3 million that was about to mature. Respondent, according to complainants, persuaded them to invest part of their funds in Bluezone, emphasising the returns that complainants would receive on their investment. Complainants accepted respondent's advice.

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8 Gauteng High Court Division, case number 50027/2014

9 See in this regard FAIS-00039-11/12 and FAIS-06661-10/11.

10 See in this regard the decision of the Appeals Board date 10 April 2015.

13. The Bluezone transactions were concluded on 7 June 2006, where both first and second complainant invested an amount of R500 000 each in the Bluezone Flextronics income plan. The balance of R300 000 was saved with a bank.

14. Respondent informed complainants that the investments were safe and could never go "bust" or fail, because the Flextronics building underlying the investment, was already established. Complainant was further advised that the income on initial investment would be 9% per annum. The capital growth was projected at 7.5% at year one. The investment was marketed as low risk.

15. At the time of the transaction, first and second complainants were 73 and 67 years of age, respectively. The invested funds represented their life savings with their only other asset being the farm they live on which is held in trust for the benefit of their children.

16. Complainants received an amount of approximately R4400 each on a monthly basis until payments stopped in September 2009. Complainants claim they were entirely dependent on the monthly payments from Bluezone.

17. Despite various attempts to resolve the matter with respondent, complainants were unsuccessful. It is alleged by complainants that respondent allegedly reassured them of the safety of their investments and offered to fund complainants' monthly medical aid premium. However, the payment never materialised. In early 2010, respondent, according to complainants, showed no further interest in assisting them recover their funds.

18. Complainants claim they had no investment experience and relied on the knowledge and experience of respondent to invest their life savings. They lament the fact that this investment, which should have afforded them financial independence and a joyful retirement has resulted in significant losses for them. Complainants claim they are now reliant on their children.

D. RESPONDENT'S VERSION

19. In compliance with Rule 6 (b) of the Rules on Proceedings of the Office of the Ombud, the Office referred the complaint to respondent during August 2012, advising respondent to resolve the complaint with his client. Respondent replied during October 2012, insisting that the Office provide

him with a notice in terms of section 27 (4), in the event the complaint is pursued by complainants. Apart from providing supporting documentation, respondent did not deal with the substance of the complaint.

20. An allegation was made by respondent in his response that complainants were receiving income from Bonatla[11]. According to information provided by complainants, the last time they received any income from Bonatla was during September 2011.

E. INVESTIGATION

21. On 30 June 2015, a notice in terms of Section 27 (4) of the FAIS Act was issued, informing respondent that the complaint had not been resolved and that the Office had intentions to investigate the matter. Respondent was invited to provide the Office with his full case, together with supporting documents, in order for the Office to begin its investigation. The letter invited respondent to deal with the question of appropriateness of advice, taking into account the risk involved in the investment and complainants' circumstances.

22. Respondent duly responded on 27 August 2015 denying negligence. Respondent further denied that he conveyed any misleading information to complainants. He claims that complainants' loss was a result of director misconduct. Respondent confirms having advised complainant to invest in the Bluezone property syndication scheme. Respondent concluded that complainants had sufficient time to consider the information and obtain alternative advice if they so wished.

23. Respondent submitted further documentation during January 2016. Included therein was a response by Mr Deon Pienaar (Pienaar) on behalf of respondent. I mention the response by Pienaar for the sake of completeness but will not deal with it for two reasons. First, Pienaar has established no real and substantive interest in the matter and is also not a party to the matter. Second, the issues raised by Mr Pienaar in his papers have already been dealt with by the Court in the matter of *Willem van Zyl & Deon Pienaar v PricewaterhouseCoopers & Others*[12]. The judgement supports the intention of the

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11 Bonatla Property Holdings Ltd (registration number 1996/014533/06) is a JSE listed company who after Bluezone was placed under judicial management, undertook to offer Bluezone investors Bonatla shares to replace their investments in the respective Bluezone schemes.

12 Case No.: 12511/2013, Western Cape High Court

legislature that providers of financial services cannot avoid their clients' losses where such losses arise out of the provider's failure to comply with the FAIS Act and its subordinate legislation.

F. ANALYSIS

24. It cannot be disputed that the parties had an agreement that respondent would render financial services to complainant. The specific form of financial service that this complaint is concerned with is advice. That advice, without a doubt, had to meet the standard prescribed in the FAIS Act and the General Code, such that any material breach of the Act and Code would amount to a breach of respondent's contractual duties.

The law

25. Section 2, part II of the General Code of the Conduct (the Code) states that a provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.

26. Section 8 (1) (a) to (c) of the General Code states that:

"A provider other than a direct marketer, 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…"

27. Section 8 (4) (b) states that where a client "*elects to conclude a transaction that differs from that recommended by the provider, or otherwise elects not to follow the advice furnished, or elects to receive more limited information or advice than the provider is able to provide, the provider must alert the client as soon as reasonably possible of the clear existence of any risk to the client, and must advise the client to take particular care to consider whether any product selected is appropriate to the client's needs, objectives and circumstances".*

28. Having considered Annexure A (attached) which provides a summary of Bluezone's training manual (used by Bluezone representatives), the marketing material in respect of the Flextronics Income Plan, the application form and the applicable legislation (specifically Notice 459), I conclude that respondent had no legal basis whatsoever to recommend this investments to his clients who could not afford to lose their retirement savings. The advice was in violation of Section 8 (1) (c) of the Code. I say so for the following reasons which are evident from the documents used to market this product:

28.1 Both the training manual and marketing material for the Flextronics Income Plan were clearly not in compliance with Notice 459. First, the documents are ambiguous and do not convey in any clear terms that investor funds will be kept in the trust account until registration of transfer into the syndication vehicle. Both documents are non-committal and coy in conveying this critical requirement of Notice 459. Respondent should have recognised this non-compliance prior to recommending the investment to complainant.

28.2 Both the marketing documents and training manual are clear that investors' funds will be moved from the holding company to the property holding company as a loan where investors will acquire 85% interest in the property holding company while Bluezone will retain 15%. There is no explanation of why investor funds have to be used to acquire 15% interest for Bluezone and its directors.

28.3 In addition to paying 85% of the investor funds into the property company as a loan, the directors made it plain that they intended to register a mortgage over the property. All the while, respondent had paid no attention to the valuation of the property and what the additional debt would mean for investor security.

28.4 None of the companies mentioned in the documents had any trading history which does not appear to have been explained to the complainants in terms of the risk they were facing. There is no indication in the marketing document that what was being sold to complainant were unlisted shares, linked to a loan account.

28.5 Not one of the warnings regarding risk to investors as required by Notice 459 are contained in any of the public documents that were used to market this investment. The Notice requires that investors be informed in clear terms that unlisted shares and debentures are not readily

marketable and the value is also not readily ascertainable; therefore, investors are at risk. On the contrary, the marketing brochure states that "*immovable property as a whole is a must component for any modern day established investors' portfolio".* However, should the company fail, this may result in the loss of the investor's entire investment. As evident from the summary, the risk was described in the documents as low. This should have immediately rang warning bells for respondent.

28.6 As evident from the summary, Bluezone was the promoter, the marketer, and property manager. Though not explicitly mentioned in the marketing documents, Bluezone was meant to manage the investor funds. Nothing was said about the fee Bluezone would be entitled to for rendering these services. Bearing in mind that there was no independent oversight body in the form of a board and investors were not represented at any decision making structure, it is fair to conclude that investors would have no protection and were at the mercy of directors right from the start. This apparent governance red flag appears to have eluded respondent.

28.7 It is clear from respondent's response that he had never seen a set of audited financial statements about any of the schemes that were promoted by Bluezone, including this particular scheme. Given the absence of an independent board, respondent had no idea how investors would be protected by ensuring that the funds would be used for what they were meant for and within proper governance prescripts.

28.8 The documents used to market this product are drafted in such convoluted fashion and are vague in a number of areas that were critical for investor protection such as compliance with section 2 (b) of Notice 459. There was also nothing said about the interest that the promoter has or would have in the scheme. None of this appears to have concerned respondent despite the high risk involved. I conclude that respondent had no idea of the risk involved in this investment and in that case, could not have appropriately advised his client.

G. PRELIMINARY FINDINGS

29. The available documentation does not hide the universal role of the promoter. The risk to investors was evident.

30. From the onset, the marketing documentation made it clear that the directors of Bluezone had intention to violate Notice 459. (See in this regard Annexure A1, where reference is made to the content of the Application form and what was intended with the funds).

31. The movement of the funds prior to registration of transfer of the property was illegal and a direct affront to the very legislation that was meant to protect investors.

32. There are problems with the proposition that investors' return was paid from the interest generated from the trust account. At the time the investments were made, interest earned on attorneys' trust accounts were between 4.5% - 5.6%[13]. Investors were promised 9 %. It was therefore not possible for Bluezone to have offered the returns it promised, unless it was funded from investors' own money.

33. Respondent failed to disclose the risk involved in the investment, violating section 7 (1) of the Code. The section calls upon providers other than direct marketers to provide (a) *'reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision.*

34. The suggestion that complainants were left with necessary documentation and had time to discuss the investments with their children or alternatively, seek advice from other sources simply confirms that respondent failed to advise complainants.

35. At the very least, complainants were entitled to accept that respondent, in rendering financial services to them, would act according to the standard contemplated in section 8 of the Code, as reinforced by section 2 of the Code which, based on all the violations cited in this recommendation, was not the case.

36. In the words of Schutz JA in the matter of *Durr v ABSA Bank LTD and Another*[14] , his lordship expressed the following timely warning:

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13 http://www.fidfund.co.za/banking-options/credit-interest-rate-history accessed on 5 June 2017

14 1997 (3) SA 448 (SCA), paragraph 466

"One of the first requirements of a professional is to know when he may be getting out of his depth, so that I do not think that that is a sufficient excuse. I am not able to say exactly what Stuart should have done. But I would suggest that there was a point at which he should have walked down the passage or across the street, or lifted the telephone, or activated the fax, and said to a lawyer, or accountant, or banker, none of which he was, in the employ of ABSA something like this: 'Look, I have been introduced to some attractive debentures (preference shares) in a group called Supreme. Would you please tell me quite what debentures (preference shares) are, and how secure they are. And also, please tell me how I find out who and what Supreme is and what risk attaches to investing in it."

37. A record of advice was completed only for first complainant which contains nothing other than what was relevant to the specific investment in question. The only two products noted on the record of advice[15] were Bluezone Investment and "Div Investment"[16]. What is pertinent from this record is that complainant was searching for a safe investment. Respondent almost in the same sentence noted that "commercial property guarantees nothing". The Bluezone investment was nonetheless recommended by respondent who emphasised that it would bring income and capital growth.

38. The risk analysis conducted on both complainants confirmed them to be <u>moderate investors</u>. This would imply that complainants were investors who wanted reasonable but relatively stable growth. Some fluctuations would be tolerable, but this type of investor wants less risk than that attributable to a fully equity based investment.

39. On his own version, respondent makes the point in the record of advice that first complainant required a safe investment, yet respondent went on to recommend a product that did not secure capital. This is indicative of the fact that respondent did not appreciate the risks involved with this investment. Further, there is no indication that respondent drew complainants' attention to the fact that their risk profiles do not match the risk involved in this investment and that complainants could lose their life savings.

40. It stands to reason that the respondents caused the complainant's loss, which loss must be seen as the type that naturally flows from the respondents' breach of contract.

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[15] Respondent indicated in his response that other products were presented to complainant (copies of quotations for products with Sanlam and Liberty Life was provided), however no comparison appears in the record of advice which includes these products.

[16] Presumably Div Holdings, also a property syndication scheme that collapsed.

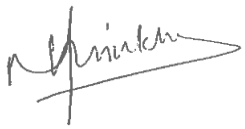
H. RECOMMENDATION

41. The FAIS Ombud recommends that respondent considers the questions raised in paragraph 28 and pay complainants' loss in the amount of R1 000 000. Each investment represents a separate and distinct cause of action. Thus, the Office has jurisdiction to consider the whole amount of R1 000 000.

42. Respondents are invited to revert to this Office within TEN (10) working days with their response to this recommendation. Failure to respond with cogent reasons will result in the recommendation becoming a final determination in terms of Section 28 (1) of the FAIS Act.

43. Interest at the rate of 10.25 % shall be calculated from a date SEVEN (7) days from date of this recommendation.

Yours sincerely



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ADV M WINKLER

ASSISTANT OMBUD