

OUR REFERENCE: FAIS 03573-11/12 WC 1

12 December 2017

**MR A JONCK & MR FRANCOIS VAN DER WALT
IMPECTUS BROKERS & FINANCIAL SERVICES CC**

Per email: ajonck@impectus.co.za ; fransvdwalt@impectus.co.za

Dear Sirs,

JACOMINA CHRISTINA MULLER and **WYNAND MULLER**¹ v **IMPECTUS BROKERS & FINANCIAL SERVICES CC**
(first respondent) and **ANDRE JONCK** (second respondent)

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

A. INTRODUCTION

1. During November 2011, the complainants filed a complaint with this Office against the respondents. The complaint arose from three failed investments that were made by the complainants during January and February 2006, on advice of the second respondent. The complainants' funds were allegedly invested in a company known as Southern Palace Investments 335 (Pty) Ltd² (Southern Palace Ltd) and the product in question, the "The Heights" income plan. The scheme itself was promoted by Bluezone Property Investments (Pty) Ltd³ (Bluezone), a Financial Services Provider (FSP) and the property company was noted as Nungu Trading 472 (Pty) Ltd

¹ In his capacity as executor of estate late JACOBUS JOHANNES MULLER, in terms of the letters of executorship issued by the Master of the High Court dated 6 March 2008

² Registration number 2005/029680/07. It should be noted that although reference is made to a "holding company", the contract provided for a (Pty) Ltd, and the registration number as noted here does not exist. Registration number 2005/029428/06 does however exist.

³ Registration number 2005/00831/07

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2. The funds invested amounted to R1 000 000⁴ in total and stemmed from the late Mr Muller's pension fund. Mr Muller retired at the age of 60 from the municipality due to ill health in 2005, and commuted one third of his pension fund as a lump sum. At the time, he was employed as a heavy duty truck driver. The first complainant was a housewife for most of her life, and the investments were their only source of income.
3. The complainants initially received their income as promised, but after the intervention of Bonatla⁵ during 2009, the income was paid either late or not at all. At first, the income dropped to less than half of the original amount, until it stopped around November 2011.
4. Mr Muller passed away during October 2007. Apart from the government pension that the first complainant has been receiving since 2012, she is financially dependent on her children. She is of the view that her investments are lost, and asked this Office for assistance.

B. THE PARTIES

5. The first complainant is Jacomina Christina Muller, an adult female pensioner whose particulars are on file with the Office. The second complainant is Wynand Muller, in his capacity as executor of estate late Jacobus Johannes Muller, in terms of the letters of executorship issued by the Master of the High Court dated 6 March 2008.
6. The first respondent is Impectus Brokers & Financial Services CC, a close corporation duly registered in terms of South African law, with registration number 1999/000128/23. First respondent is an authorised financial services provider (license number 11860) with its principal place of business noted in the regulator's records as 31 Market Street, George, 6529, Western Cape. The license has been in force since 20 October 2004.
7. The second respondent is Mr Andre Jonck, an adult male and representative of the first respondent. His address is the same as that of the first respondent.

⁴ R500 000 for each complainant respectively

⁵ 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.

8. At all material times, second respondent rendered financial services to the complainants. I refer to the first and second respondents as “respondent”. Where necessary, I specify which respondent is being referred to.

Delays in finalising this complaint

9. Given our mandate to resolve complaints expeditiously, it is important that I deal with the delay in finalising this complaint. Sometime in September 2011, after the Office issued the *Barnes* determination⁶, the respondent in that matter brought an urgent application to set it aside⁷. Before the fate of the application could be known, the respondents sought an undertaking from this Office that it would not proceed to determine any other property syndication related complaints involving them.
10. Since no legal basis existed for the respondent’s demands, the Office proceeded to determine further property related complaints, to which the respondents replied with an urgent application for an interdict to stop the Office from filing the determinations in court and issuing further determinations against them. The decision, favouring the FAIS Ombud, in the original application was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*⁸.
11. The Office continued to determine complaints involving property syndications after the High Court decision⁹. However, in 2013 following the *Siegrist* and *Bekker* determinations¹⁰ 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 precautionary and necessary risk-management step, as the Office had for the first time sought to hold the directors of property syndication schemes liable for complainants’ losses. The said appeal was finally decided in April 2015¹¹, after which the Office

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

⁷ The respondent claimed that section 27 of the FAIS Act was unconstitutional

⁸ Gauteng High Court Division, case number 50027/2014

⁹ Referred to in paragraph 6 of this recommendation

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

¹¹ See in this regard the decision of the Appeals Board date 10 April 2015

resumed processing complaints involving property syndications, with due regard to the *Siegrist and Bekker* decision. As many as 2000 complaints had to be shelved pending the Appeals Board decision.

C. THE COMPLAINT

12. The first complainant indicated that she and her late husband approached the respondent during 2005 for financial advice, following his decision to retire due to ill health. The complainants did not have any experience in financial products, and sought the best investment that would ensure capital growth and provide them with sufficient monthly income.
13. The respondent visited the complainants at their home, where he briefly discussed some financial products with them. He presented them with a colourful brochure of Bluezone, and explained that an investment in The Heights would be the best investment option. The respondent explained that the money would be invested in a building, specifically student accommodation. He also explained the yearly growth, showed them illustrative values and assured the complainants that their money would be safe and ostensibly risk free.
14. During January and February 2006, the complainants made the following investments:
 - 14.1 R140 000 in the name of JC Muller (first complainant)
 - 14.2 R360 000 in the name of late JJ Muller
 - 14.3 R500 000 in the name of JC Muller
15. After the income stopped, the complainant, with the assistance of her sons, was unsuccessful in her attempts to resolve the matter with the respondent. Despite Bluezone's very public financial challenges, the respondent continued to assure the complainant of the safety of her investments. The complainant, however, learned of Bluezone's financial woes through the media, and became increasingly worried about her deteriorating financial situation.
16. The complainant stated that they contacted the third respondent because they believed that he would provide with them with professional advice. The complainant also noted that she followed his advice a second time when he informed her that Bluezone would go into liquidation and that she had to "surrender" (sic) her share certificates to Bonatla, from which she has also not received income since 2011.

17. The complainant is struggling to make ends meet and stated that she is now living the life of a pauper.

D. RESPONDENT'S VERSION

18. In compliance with Rule 6 (b) of the Rules on Proceedings of the Office of the Ombud, the Office referred the complaint to the respondent during November 2011, advising him to resolve the complaint with his client. No response to the notice was received.

19. On 30 August 2012, a notice in terms of Section 27 (4) of the FAIS Act was issued, informing the respondent that the complaint had not been resolved and that the Office had intentions to investigate the matter. The respondent was invited to provide the Office with his case, together with supporting documents, in order for the Office to begin its investigation. The letter invited the respondent to deal with the question of appropriateness of advice, taking into account the risk involved in the investment and complainants' circumstances.

20. The respondent's reply was finally received during November 2012. The salient points are summarised below:

20.1 The respondent confirmed having met with the complainants during November 2005 to discuss their financial position. During the financial planning process, the respondent made provision for emergency funds, settlement of the complainants' bond and other debts, purchasing of a vehicle, as well as improvements to their home.

20.2 The respondent did the necessary tax calculations and conducted a risk profile analysis, which confirmed the complainants to be moderate investors. The complainants, according to the respondent wished to maintain the same monthly income as prior to Mr Muller's retirement.

20.3 The respondent compared various companies' income plans and presented the income comparisons to the complainants, with an explanation in respect of the difference between property syndications and guaranteed income plans. The respondent claimed that the complainants did not want to take the other plans on offer, because of the lower monthly income compared to that of Bluezone. A portion of the capital available for investment was placed in a Stanlib money market account.

- 20.4 The respondent claimed that he only presented the different investment options and comparisons. The complainants were in a position to make their own decision based on the information he provided. It was the complainants' decision to elect the Bluezone income plan, as it would suit their lifestyle.
- 20.5 The respondent also stated that he never made any promises of guarantees (of capital or income) in respect of property syndications. To this effect, the application forms were clearly marked as "no" in respect of the question about guarantees.
- 20.6 Following the death of Mr Muller, the respondent continued to assist the first complainant with her financial affairs. He also continued to update her with whatever information became available to him in respect of Bonatla.
- 20.7 In conclusion, the respondent expressed empathy for the situation that the complainant finds herself in. He stated that she is still receiving an income, albeit infrequently and there is hope that her capital would grow with Bonatla if they keep their promises to investors. Respondent made these statements without providing any basis for his conclusions.
21. Further notices were issued in terms of section 27 (4) during February 2016 and June 2016. The respondent indicated that he had nothing new to add.

E. INVESTIGATION

22. The respondent was provided with a further opportunity during July 2017 to address the Office in terms of section 27 (4) of the FAIS Act. Some of the questions raised (omitting words not essential) are set out below:
- *The prospectus / marketing document of Bluezone states that Bluezone was the promoter, the company secretary, property manager and manager of investor funds. Given the overlapping roles and the obvious conflict of interest, what steps did you take to ensure that your client will be protected against director misconduct?*
 - *Are you able to provide evidence that you had ascertained the cost levied by [Bluezone] for the services mentioned in line 3.1?*

- *The prospectuses further inform potential investors that there is essentially no independent board of directors.... Given that there was no independent board of directors (as provided for in King III), what steps did you take to satisfy yourself that your clients will be protected against director misconduct?*
- *Given the absence of an independent board, what steps did you take to ensure that there are sufficient safeguards and controls internally to ensure that investor funds were utilised for what they were meant for, and in line with proper governance prescriptions?*
- *You should be aware that the oversight of a board includes the appointment of an audit committee whose function, amongst others, is to receive assurance from an independent audit firm. An audit committee's oversight also includes satisfying itself that there are proper controls within the entity, and that the information contained in the financial statements of the entity can be relied on. Given there was no audit committee and no audited financial statements, what information did you take into account to conclude that this was a viable investment?*
- *We would like you to set out the steps you took to understand the risk involved in this product. Please attach supporting documentation to your response to demonstrate the information you considered.*
- *Did you ever confirm the valuation figures shown in the prospectus, with the property valuer cited in the prospectus?*
- *What was the response of the property valuer in relation to the figures quoted in the prospectus for the buildings? We require written confirmation of your request to the valuer, prior to your client concluding the transaction complained of.*

23. The respondent replied on 17 July 2017. Briefly, he indicated that:

23.1 Enquiries were made about the operations of Bluezone with the directors who visited the respondents at their offices in George. The respondents were impressed with Bluezone's buildings and the manner in which Bluezone structured their deals. The respondent noted that Bluezone had been in business for a number of years, and the FSB could not provide any

information that would have raised alarm bells about the type of business they were conducting. To this extent, everything possible was done. The respondent considered an investment in The Heights as solid, as it had rental contracts in place.

23.2 The respondents were satisfied that Bluezone was a “legal FSP”. They claim they went as far as drawing the details on Mr Lamprecht’s (CEO of Bluezone) financial portfolio from Astute. The respondents do not state how this information assisted them in ascertaining the viability of Bluezone’s offering to the investors.

23.3 No information was requested about the valuation. The respondent maintains that the building had good prospects and should not have been included in the Bluezone liquidation.

F. ANALYSIS

24. It cannot be disputed that the parties had an agreement that the respondent would render financial services to the 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"*.

G. CONSIDERATION OF THE MATTER

28. Having considered the attached summaries of Bluezone's marketing material, as well as the sale of shares and investment agreement, I conclude that the respondent had no legal basis to recommend these investments to his clients given their circumstances and their claims that they could not afford to lose their retirement savings. The advice was in violation of Section 8 (1) (c) of the Code. My reasoning is set out below:

28.1 There is no evidence that an independent board of directors existed within the group of companies. This is, for example, confirmed by the signature of Mr van Niekerk in his capacity as the director of the property company, the holding company and the principal in the sale of shares agreement.

28.2 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.

28.3 It is clear from the respondent's reply that he had not 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, the respondent had no indication as to how investors would be protected by ensuring that the funds would be used for what they were meant for, and within proper governance prescripts.

- 28.4 As is evident from the summary, Bluezone was the principal, the marketer, and property manager. Though not explicitly mentioned in the marketing documents, Bluezone was meant to manage the investor funds. A basic knowledge of corporate governance¹² would have alerted the respondent to the inherent risks of this glaring conflict of interest.
- 28.5 The marketing documents make clear that investors' funds will be moved from the holding company to the property 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 had to be used to acquire 15% interest for Bluezone and its directors.
- 28.6 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, the respondent had paid no attention to the valuation of the property and what the additional debt would mean for investor security.
- 28.7 None of the companies¹³ 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 the complainants were unlisted shares, linked to a loan account. Despite the aforesaid, the risk was described as low.
- 28.8 The sale of shares agreement is clear that all subscription payments shall be applied by the attorneys to paying all costs, which included the attorneys' fees, charges and expenses. What these expenses and charges entailed, are not explained. These apparent governance red flags appear to have eluded the respondent.
- 28.9 I conclude that the respondent did not appreciate the risk involved in this investment and in that case, could not have appropriately advised his client.

¹² Reference is drawn to the King II report where one of the seven characteristics of good corporate governance is independence. It is explained as: *"Independence is the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareowner. These mechanisms range from the composition of the board, to appointments to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences"*.

¹³ This includes Nungu Trading 472 (Pty) Ltd and Southern Palace Investments 335 (Pty) Ltd

29. The complexities of the Bluezone agreements were pointed out by the Appeals Board in the matter of *ACS Financial Management CC and Others v PS Coetzee*¹⁴. The Board noted in paragraphs 38 – 39 that:

Although the agreement purports to be a subscription of shares by the investor in a holding company, Pacific Breeze (Pty) Ltd, it was not a subscription of shares at all but instead a purchase of (inter alia) shares from third parties. Lest the significance escape the attention: money paid for subscribed shares forms part of the share capital of the company; money paid for the purchase of shares accrues to the seller and not the company.

It goes further. The sellers of the shares in Pacific Breeze were not identified and were also not parties to the agreement. The number of shares bought was also not quantified. In other words, the respondent bought from undisclosed shareholders of Pacific Breeze (the sellers) an unquantified number of their existing shares. (A share certificate issued later reflected 530 shares at R1 per share, which means that she paid R100 010 – the so-called subscription price – for 530 shares of R1 in a company without any disclosed assets.)

30. The sale of shares and investment agreement in this instance left the complainants in the same predicament in that they also contracted with an unknown seller. To this extent, the “seller” in the agreement concluded by the complainants, is merely defined to mean “*the shareholders of the Holding Company in respect of the sale of shares to the subscriber*”. The sellers were not defined, and were not party to the agreement. It is unlikely that the complainants would have understood the intricacies of the said agreement and agreed to it, even if the respondent was in a position to explain it to them.
31. Nowhere in respondent’s replies to this Office are the risks mentioned in my analysis covered. I conclude that the respondent failed to disclose the risk involved in the investments, 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.*

¹⁴ FAB 1/2016. See paragraphs 36 - 48

32. By his own admission, the respondent noted that the complainants were moderate investors. This would imply that the complainants 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 investment¹⁵. The complainants also had no investment experience.
33. The recommendation to invest in Bluezone was on the basis that it offered the highest return, because this is what the complainants required on respondent's version. This much is noted in the advice record. There is no information evidencing that the respondent was concerned by the complainants' lack of capacity to absorb high risk.
34. That the complainants wanted to make the investment in Bluezone, according to the respondent, does not absolve him from his duties in terms of the Code. The respondent still had a duty in terms of section 8 (1) (c) to identify products that would be suitable to the client's risk profile and financial needs, regardless of what the complainants thought would have been in their interest. There is no indication that the respondent drew complainants' attention to the fact that their risk profiles do not match the risk involved in this investment and that the complainants could lose their life savings.
35. At the very least, the complainants were entitled to accept that the respondent, in rendering financial services to them, would act according to the standards contemplated in section 8 of the Code as reinforced by section 2, 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*¹⁶, his lordship expressed the following timely warning:

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

¹⁵ As noted in the Investment Portfolio Guide of the Bluezone Investments documentation

¹⁶ 1997 (3) SA 448 (SCA), paragraph 466

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. 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.

H. RECOMMENDATION

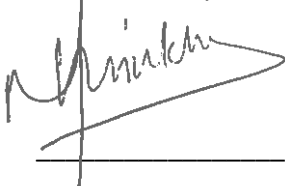
38. The FAIS Ombud recommends that the respondents pay the complainants' loss as set out below:

38.1 R500 000 in respect of the first complainant; and,

38.2 R500 000 in respect of the second complainant.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'ADV M Winkler', written over a horizontal line.

ADV M WINKLER

ASSISTANT OMBUD