

IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

CASE NO: FOC 04114/08/09 WC 1

In the matter between:

BERNARD FREDERICK DUDLEY

Complainant

and

LIFESURE FINANCIAL SERVICES C C

Respondent

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

A. THE PARTIES

[1] Complainant is Bernard Frederick Dudley a male retiree who resides at 16 Farmside, Western Cape.

[2] Respondent is Lifesure Financial Services CC, a close corporation duly registered in terms of South African laws with its principal place of business at Seardel House, Alpheia Park, Constantia, Western Cape. Respondent is an authorised financial services provider in terms of the

FAIS Act, with licence number 17741, represented at all material times by Nigel Segers ('Segers'), a member and key individual of respondent.

B. THE COMPLAINT

[4] Complainant invested an amount of R495 000, 00 in November 2005 with Network 2 The Company Ltd, trading as PropDotCom 3, ('Propdotcom 3 '), following advice from respondent. The investment was positioned as, to use the words of respondent, an "*investment in commercial property (office suites, retail shopping malls and industrial parks) provide an excellent opportunity to grow capital whilst providing you with a regular income .*" In his complaint, complainant states:

"I was not familiar with the company and questioned Mr Segers about their status. He vouched that the company was completely sound and that all essentials have been checked and that he was confident of the investment."

Monthly income payments from the investment commenced in December 2005. It is common cause between the parties that in some months income payments were late. In August 2007 however, all payments from Propdotcom 3 ceased. Since then, complainant has not been paid anything in connection with the investment. Complainant is of the view that he has lost his entire capital.

Complainant is seeking an order from this Office compelling respondent to refund his capital together with interest. The basis for complainant's claim is that, respondent by recommending that he invests in Propdotcom 3, when all that it had done was a superficial diligence of the entities involved violated the duty placed on providers to act with due care, skill and diligence when rendering financial services to clients.

C. INVESTIGATION

(i) Background

The following undisputed facts emerged during investigations conducted by this office:

[5] Complainant is 70 years old. He has been a long standing client of respondent. At the time of the investment he was 66. In 2005, respondent presented an investment offered by Blue Pointer, a promoter of property syndication business to complainant.

[6] Complainant had sought respondent's services in investing the amount in question with a view to obtaining a steady income. The decision as to the type of investment to be recommended rested with respondent with no

specifications from complainant. Respondent was at all times aware of complainant's financial status and that he is a retiree.

- [7] Before recommending the investment, Segers attended a presentation where Blue Pointer presented its product to financial advisors. At that meeting, a prospectus concerning Network 2 The Company Limited, t/a PropDotCom 3, was made available. In terms of the prospectus, Propdotcom 3 would acquire the shares of a private company known as Nordic Saga Investments, 239 Pty Ltd, registration number 2003/04089/23. The latter company was to have been the entity that would acquire the immovable properties to provide rental income, namely, Letaba Boulevard Centre in Tzaneen and Unit 1 Willow Street in Bellville. Due to the fact that respondent was not licensed to render financial services in relation to shares, it applied to be appointed as agents of Blue Pointer Marketing (Pty) Ltd in November 2005. The agency arrangement however never came into fruition because, Blue Pointer Marketing (Pty) Ltd was in its own right unlicensed. This is a fact respondent discovered when things were obviously going wrong.

- [8] After attending the presentation respondent discussed the investment with complainant. Segers states that in studying the prospectus he noted several factors. It is these factors that ultimately persuaded respondent to conclude that the investment was suitable to address complainant's need:-

1. *The Prospectus was registered by the Registrar of companies on the 11th November 2005,*
2. *The bankers being ABSA bank*
3. *Auditors were KPMG*
4. *Transferring attorney's (sic) were Du Toit Binedell*
5. *Marketers of the syndication – Blue Pointer – a licensed FSP in accordance with the FAIS Act*
6. *Directors PropDotCom directors of the Holding company (sic)*
7. *The investment was secured by the property that was unbonded.¹*

[9] In addition, Segers states that complainant was also furnished with the prospectus for studying.

[10] It is pertinent to mention at this stage that the detail involving the prospectus is dealt with in paragraph 32.

[11] The investment was placed in November 2005. In December 2005, when complainant received his first monthly income distribution, payment was made in cash. Complainant states he was unsettled by this and he communicated his concerns to respondent. He was however assured that there was no reason to worry. In February 2006, not long after the cash payment, complainant's income was not paid. He informed respondent who took the matter up with Blue Pointer. Respondent was informed that due to power blackouts, Blue Pointer's systems were faulty and that income would be paid into the investors' bank accounts manually.

[12] In April 2006, complainant's attention was drawn to an article in the Mail & Guardian, (M&G). The article was a public alert issued by the Financial Services Board, (the FSB), warning the public to exercise caution when dealing with one Louis Baartman, ('Baartman') of Blue Pointer. Searching the internet for further information, complainant came across information supporting the content of the article. The M & G article read:

'The Financial Services Board (FSB) on Tuesday issued a warning to consumers to be cautious when doing financial services business with Blue Pointer and /or Lodewyk Petrus Baartman. The FSB's deputy executive officer for financial advisory and intermediary services and market conduct, ...says Blue Pointer/ Baartman have been the subject of an FSB inspection carried out in terms of the Inspection Act.....'

"From the inspection it emerged that Baartman represented Blue Pointer Business Administrators (Pty) Ltd ('Blue Pointer') and Propdotcom ("PDC") Property Consortium. Blue Pointer is a company managed by Baartman, which marketed property syndication investments in PDC to the public,"

"The FSB's inspection into the affairs of these companies revealed that Blue Pointer acted as an unlicensed financial services provider by providing advice and intermediary services in respect of the shares sold in PDC to the public. The conducting of unauthorised financial services business is an offence in terms of the Financial Advisory and Intermediary Services Act, 37 of 2002. The inspectors found that the operations of Blue Pointer and PDC were managed by Baartman

as one enterprise. This resulted in PDC client funds being used to fund the operations of Blue Pointer. Complaints were also received in respect of other investment activities of Baartman," said the FSB....."

[13] When complainant brought the information about the article to the attention of respondent, he was assured by Segers that he had investigated the matter and that the article was about an outstanding civil case against Baartman and not connected with Blue Pointer. As may be apparent already, Segers misdirected himself in this regard. The wording of the article was specific. It had nothing to do with outstanding civil cases against Baartman but his ability to render financial services to the public.

[14] In August 2007 when all payments from Propdotcom 3 ceased, complainant immediately instructed Segers to withdraw his investment from Propdotcom 3. It is at this point that respondent learnt that Blue Pointer had 'closed doors' and had allegedly been fired by the directors of the holding company, Propdotcom and that a company known as Uniprop would take over the administration and management of all investors. Several exchanges of correspondence took place between complainant and respondent, with complainant seeking refund of his investment. These never bore any favourable outcome for the complainant. He later lodged a complaint with this Office.

[15] When respondent contacted Blue Pointer about complainant's unpaid income and sought to sell complainant's investment, it was advised that Blue Pointer could sell complainant's investment but could not find any buyers. In December 2007, a meeting was called with the directors and shareholders. Apparently, the only people who turned up were, one Fiek Gamielien, Jahala Cloete, Graham Falck, complainant and Segers. At this meeting they were informed that the reason complainant's income stopped was that there were no properties and therefore no income to pay. On questioning how this happened, they were advised that the transferring attorneys paid the capital directly to Blue Pointer and that a building was purchased and sold without the necessary approval. It is at this point that respondent, decided to see it's attorneys and asked for an investigation into the matter, a step that he perhaps should have considered taking in the beginning.

[16] The outcome of the investigation conducted by respondent's attorneys was summarised by respondent, thus:-

- Blue Pointer was denied a license as an FSP. Baartman was found unfit to hold a license in terms of the FAIS Act;
- The prospectus was never registered;
- KPMG were never appointed as auditors;

- The transferring attorneys were negligent in paying the funds to Blue Pointer and not the sellers;
- What happened to the R6 million taken by the transferring attorneys is unclear as the then directors were loathe to share any information.
- Its attorneys were of the opinion that there was as a strong case against the transferring attorneys.

[17] At the meeting of shareholders held in December 2007, complainant and respondent were advised to transfer complainant's investment in Propdotcom 3 to a development in Gaasbaai with Uniprop. Complainant signed the transfer form, however, it was agreed between respondent and complainant that they would not submit the form. They did however request Uniprop to find a buyer for complainant's shares.

(ii) **Behind the Blue Pointer empire**

[18] This office is privy to a report compiled by the FSB, following an inspection conducted on the affairs of Blue Pointer entities in terms of section 3 of the Inspection of Financial Institutions Act, (Act No.80 of 1998). The inspection was conducted in 2006. The mandate of the inspectors as set out in the inspection letter dated 1 December 2005 was to carry out an inspection of the affairs of the following entities, person and their associated institutions:

- a) Blue pointer Business Administrators (Pty) Ltd;
- b) Blue Pointer Marketing (Pty) Ltd;
- c) Blue Pointer Share Traders (Pty) Ltd;
- d) PropDotCom Property Consortium; including
 - Turquoise Moon Trading 46 Limited trading as PropDotCom No1;
 - Network 2 The Company Limited trading as PropDotCom No.3
- e) Chris J van Tonder (FSP) No. 2019; FSB No. 7895.

I thank the FSB and the persons who compiled the report as it made the work of investigating this and a number of other complaints associated with investing in the Blue Pointer group of companies relatively light. There is no need to go into detail about most of the companies aforementioned; reference is only confined to those aspects that are absolutely necessary.

The Blue Pointer companies

- [19] According to the report, Blue Pointer is a name used to refer to a group of companies managed by Baartman. Blue Pointer markets property syndication investments to the general public. At the time, Blue Pointer had offices in Cape Town, Pretoria, Bloemfontein and Durban. PropDotCom is a brand name used in marketing and promoting the property syndications of Blue Pointer. Turquoise Moon Trading 46 Limited

trading as PropDotCom No.1; and Network 2 - The Company Limited trading as PropDotCom No.3 are both unlisted public companies used for selling the shares to the public. Network 1 – The Company Limited trading as PropDotCom No.2 was registered but the prospectus was never issued for selling shares.

[20] The following companies also formed part of the group:-

- (a) Blue Pointer Business Administrators (Pty) Ltd. The directors at the time were Lodewyk Petrus Baartman, ('Baartman'), the man who designed and invented the property syndication business of Blue Pointer and one Werner Louis Coetzee;
- (b) Blue Pointer Marketing (Pty) Ltd, the directors at the time are set out as Baartman, Judith Deborah Ferdinando and one Joseph Thee;
- (c) Blue Pointer Share Traders (Pty) Ltd, trading as Blue Pointer Event Management, the directors are Baartman and one Evert Grobbelaar Loubser;
- (d) Shock Proof Investment 76 (Pty) Ltd trading as Blue Pointer Properties, the director is one Janine Stratford Burke;
- (e) Sat-vest Holdings Limited, the directors are Baartman and Werner Louis Coetzee; and
- (f) Blue Pointer Group of Companies Ltd, directors are Baartman and Werner Louis Coetzee. This is a public company. It is astounding

that Baartman is a director even though he has been convicted criminally.

The PropDotCom companies

[21] There appeared to have been eight PropDotCom companies, namely:-

- (a) Turquoise Moon Trading 46 Limited;
- (b) Golden Pond Trading 32 (Pty) Ltd;
- (c) Motifprops Pty Ltd;
- (d) Network 1 The Company Limited trading as PropDotCom No.2;
- (e) Southern Spirit Properties 113 (Pty) Ltd;
- (f) Network 2 The Company Limited trading as PropDotCom No.3;
- (g) Razorbill Properties 405 (Pty) Ltd;
- (h) Nordic Saga Investments 239 (Pty) Ltd

How Blue Pointer operations were conducted

[22] According to the report Blue Pointer secured offers to purchase commercial properties in the name of private companies. A public company would then be incorporated as holding company of the property owning company. Thereafter, they registered a prospectus at the Registrar of Companies in terms of the Companies Act on behalf of the public

company and issued shares for subscription to the general public. The prospectus offered linked units each consisting of one Class B ordinary share of R1.00 in the public company and an unsecured interest free loan to the company with a nominal value of R14 999. Investors applied for shares and made deposits to the trust account held by Du Toit Binedell Inc. Funds were transferred to the public companies that lent money to the property owning companies to buy properties listed in the prospectus. The property owning companies purchased the properties and leased them. The cash flow from rentals should have been used to repay the loans from the public companies. The public companies ought to have paid the investors of class B shares.

- [23] The report also pointed that investors' funds did not follow the intended path as funds destined for PropDotCom companies were mingled with Blue Pointer funds even though separate bank accounts for PropDotCom companies existed. Blue Pointer did not maintain proper accounting records. Transfers of investment funds from the trust account were not separately accounted for in separate books of the public companies because no separate books were maintained. There was only one relevant set of books in the name of Blue Pointer Trading where most of the accounting entries for Blue Pointer/PropDotcom companies are accounted for. It was further pointed out in the report that funds were applied towards funding the operations of Blue Pointer companies for a period of at least

two years; purchasing assets for the Blue Pointer Group; advancing other legal entities and subsidiary companies and advancing Baartman. It also appears from the report that several amounts were paid by shareholders to Baartman for shares bought in Blue Pointer Marketing (Pty) Ltd and Sat-vest Holdings Limited. Apparently the amounts were explained by Baartman to be proceeds from the sale of his shares in the two companies which were accounted for in the CTJ Family Trust account as a shareholder's loan to Blue Pointer Trading. CTJ was the only shareholder in the Blue Pointer Group of Companies. The latter is what Baartman described as the holding company during the inspection.

(iii) Referral of complaint to respondent

[24] In terms of the rules on proceedings of the FAIS Ombud, the complaint was referred to respondent. In its initial reply, respondent raised the following pertinent points:-

(a) The investment was offered to complainant, after taking into account pertinent information from the prospectus. The information is set out in paragraph 8 (items 1-7). In addition to this information, respondent relied on the fact that:-

- complainant would acquire shares in the holding company, ie Network 2 The Company Ltd;
- complainant's capital was to be paid to the transferring attorney for on- payment to the sellers of the properties; and
- in return, complainant would be paid a proportion of the net rental income as outlined in the prospectus.

(b) Respondent had been advised by its attorneys that in fact a claim existed against the transferring attorneys.

[25] As the matter was not resolved, the case was admitted for investigation.

This office issued a Notice in terms of section 27 (4) of the Fais Act indicating to respondent that the matter was to be accepted for investigation and further requested any documentation in their possession which would assist respondent in their case. The gist of it's defence is set out here below:-

a) A face to face meeting was held with Segers and complainant wherein the merits of the property syndication investment were considered. At this meeting, Segers handed the prospectus to complainant whereupon, the issues set out in paragraph 8 were once again re-visited. Respondent submits that both Segers and complainant agreed that all the institutions mentioned in paragraph 8 were credible and

neither presented any risk since the property would not be encumbered by a mortgage loan.

- b) Respondent further submitted that the proceeds was sufficient to pay real net income to the investors with the added growth potential on the property itself;
- c) It was further agreed that since shares in property is a fairly secure investment medium, a risk analysis would be superfluous;
- d) That after studying the prospectus for a few days, complainant made the investment.
- e) It is respondent's belief that complainant's losses are a direct result of the transferring attorneys who paid investors' funds to Blue Pointer, instead of paying to the seller or back to the investors, since the minimum subscription had not been attained.
- f) Finally, respondent states that they had also approached their Professional Indemnity insurers to see whether there was any negligence on their part and were advised by them that they found no negligence, concluding there could be no claim.

[26] It is perhaps apposite to mention a few things at this stage; first, no record has been submitted to this office stating the advice furnished to complainant, the basis for the advice, what other financial products were considered and why an investment in property syndication was considered

the most suitable to address complainant's needs. Part VII, section 9 of the General Code of Conduct, (the Code) requires providers to:-

[26.1] maintain a record of the advice furnished to a client as contemplated in section 8;

[26.2] such record must reflect the basis on which the advice was given;

[26.3] in particular, a brief summary of the information and material on which the advice was based, the financial products considered, the financial products recommended with an explanation of why the product or products selected is or are likely to satisfy client's identified needs and objectives.

D. DETERMINATION AND REASONS

[27] The following are to be decided:

- (i) Did respondent's conduct whilst rendering financial services violate the provision of the FAIS Act, specifically, the duty to placed on providers of financial services to act with due skill, care and diligence and in the interests of clients and the integrity of the financial services industry when rendering financial services to clients?

- (ii) If the finding in this regard is in the affirmative, did such violation cause complainant the damage complained of?
- (iii) The quantum of such damage

Did respondent's conduct whilst rendering financial services to complainant violate the provisions of the FAIS Act, in particular, the duty to act with due skill, care and diligence and in the interests of clients and the integrity of the financial services industry?

[28] For convenience, the question is dealt with under the following headings:-

- (a) The Financial Services Provider in Blue Pointer was not licensed;
- (b) Respondent had done a superficial diligence on the entities involved;
- (c) Respondent had no real appreciation of how property syndications work and the required disclosures

(a) *The Financial Services Provider in Blue Pointer was not licensed*

[29] Part II section 2 of the General Code of Conduct, (the Code) places a general duty on providers to 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. At its basic meaning, the duty places a responsibility on providers to act within the confines of the law. On their its version, respondent merely assumed that the Financial Services Provider in Blue Pointer was licensed. It proceeded

with an application to be appointed as an agent of Blue Pointer. Admittedly, not all the entities within the Blue Pointer stable had to be licensed. However, the entity rendering financial services to the public had to be licensed. In this case, it was not. This means, not only was respondent violating Chapter 1 section 3 (a) of the Financial Advisory and intermediary Services Regulations, (the Regulations) by marketing and canvassing a business related to the rendering of financial services by a person who is not authorised in terms of this Act, they, (and this is important) exposed complainant to the risk of entrusting his savings with an unlicensed entity.

- [30] Respondent merely accepted, upon a representation from Blue Pointer Administrators, that the latter was licensed. Respondent was presented with no proof either by Blue Pointer Administrators or by anyone else that the firm was licensed to render financial services in relation to shares. When respondent was asked to provide this office with a copy of the agreement, it sent a copy signed only by Segers. This appears to be a double edged sword as the signing of the agreement would not have assisted the respondents. Their unlicensed status would not have been changed by an agency agreement with an unlicensed entity. Respondent was willing to put a signature to a document where quite clearly they did not verify Blue Pointer's license status.

[31] A specific issue that needs to be dealt with here is that the risk associated with doing business with an unlicensed entity is not the same as risk inherent in the nature of an investment. Thus, the repetitive acts of paying complainant's rental income late and blaming it on, amongst other things, power outages; the act of paying complainant's income by means of a cash payment, which could have exposed the parties involved to the risk of fraudulent activity; and the non payment of clients' promised return are all matters that should have been foreseen by any provider acting with due skill and diligence in an operation that is not subject to any rule.

(b) *Respondent had done a superficial due diligence on the entities involved in the public property syndication.*

[32] Respondent's version is, that the recommendation to invest in the property syndication was made after consideration of certain information set out in paragraphs 8 and 24 herein, as well as complainant being provided with a copy of the prospectus. The information which respondent concentrated on added no value to the assessment of the risk involved in investing in a share. A prospectus is supposed to provide extensive information about a company. At the same time, it can convey irrelevant information to defraud investors. Unless the provider analysing the prospectus knows what to look for and is prepared to act diligently, the advice might be disastrous as has been the case here.

In fact, a lot of what was on the prospectus was either false or useless information from the point of view of assessing risk and stability of the company. KPMG had nothing to do with Blue Pointer. The fact that Blue Pointer banked with Absa was not information one could take into account for assessing the risk carried by Blue Pointer. Blue Pointer was not licensed and the statement, 'Directors Propdotcom directors of the Holding company', conveyed nothing to complainant in terms of risk assessment. Registration of the prospectus is also no indication that the registrar is approving the merits of the offering to the public.

Any financial services provider who intends to recommend an investment in a property syndication to a client must first obtain all the available information about the promoters as well as the financial viability of the underlying investment before the product can be presented to a client. Put simply the FSP is expected to first satisfy itself that the investment is sound. The investor upon being presented with such a product is entitled to accept that the FSP has satisfied himself that the product and its promoters are sound.

Respondent had no knowledge of Blue Pointer's history, no idea of who was behind the entity and no information as to the track record of the persons behind the company matter. Worse, it carried out no independent

verification of what was presented in the prospectus. It was open to it to seek this information. A glance at the prospectus indicates that the promoters deliberately intended to be economical with information relating to the financial details of the company. The information provided in the prospectus in relation to financial standing of the company is so inadequate that no reasonable provider acting in the interests of his or her client could have recommended the investment. Clearly, the information in the prospectus was vague, vague enough to raise concerns in the mind of a diligent FSP. The following support the foregoing conclusion:-

- [32.1] Respondent had no idea what rights are attached to each class of shares. The prospectus states clearly that the linked share is made up of R1's worth of a share and an unsecured claim offered to the public at R14 999 per claim. On its own version, respondent failed to disclose the true meaning of the latter to complainant.
- [32.2] It would have been prudent of respondent to have sought information as to how the syndicators arrived at the number of 2940 for the linked units.
- [32.3] Notwithstanding that the proforma balance sheet clearly omits class A shares, respondent did not see any anomaly in this. It did not

question why class A shares were not included in the balance sheet.

[32.3] None of the financial information provided is independently verified by auditors. The included letter in the prospectus purportedly from KPMG should have placed respondent on its guard. It lacks any indication that it emanates from KPMG. The letter is not signed nor does it a single official detail of KPMG.

[32.4] Notwithstanding the statement in the prospectus that Propdotcom intended to purchase shares in Nodic Sarga, respondent did not consider it necessary to find out any details about Nordic Saga. On his own version he did not. It did not establish what amount would be paid for the purchase of Nordic Saga and whether this would make commercial sense before recommending the investment to complainant.

[32.5] Respondent did not consider it necessary to see an independent valuation of the properties to be purchased. It did not satisfy itself that indeed the properties would be purchased in the name of Nordic Saga. Segers on behalf of respondent was nonetheless able to advise complainant that his investment would be secured by the

'unbonded' immovable property and even promised that there was potential for capital growth.

[32.6] Respondent did not verify any of the claims about the existence of the leases and never thought of doing any due diligence on either the properties or the leases. It recommended to complainant that he invests in the syndication even though he had no clue about the physical state of the immovable property to be purchased, the areas where the properties are situated, whether or not there were tenants in the properties and what term was left to run on any of the leases. He had no idea whether the immovable properties were indeed worth what was going to be paid by the investors.

[32.7] The share capital did not include the amount paid for class A shares. Respondent did not see the need to question that aspect.

[32.8] The prospectus refers to 'commission goodwill' of 8 %. 1st did not consider it necessary to establish what exactly is meant by commission goodwill and why should it cost investors 8 % of their capital.

[32.9] The prospectus refers to Non Distributable Reserves (NDR) of R12 million. There is no detail as to how the amount was calculated. This also did not interest respondent.

[32.10] There are projected borrowings that go to R23 million by year five without any substantiation. On his own version, respondent never thought of questioning this.

[32.11] The pro-forma balance sheet contains current assets without providing any explanatory note of what makes the amount. Still, this did not interest respondent.

[32.12] What makes a mockery of the whole financial presentation is that the financial information, which is supposedly backed by existing leases is set out in a speculative nature and not exact figures. Respondent did not ask any questions about this. At best, the information was vague.

(c) Respondent had no real appreciation of how property syndications work and the required disclosures

[33] Property syndication fraud is rife in this country, costing investors millions of rand. The legislature took positive steps by publishing legislation to prevent property syndication fraud. All financial services providers have a

duty to be familiar with the legislation and apply it. The following are the minimum mandatory disclosures that respondent should have made. They are contained in Government Gazette No. 28690, Notice No. 459 of 2006 issued by the Department of Trade and Industry, in terms of the Consumer Affairs (Unfair Business Practices) Act, 1988, (the Gazette). Attached to the Gazette is Annexure A which contains the disclosures. The disclosures are to be made by promoters of property syndicates. By extension, any provider who carries in his portfolio of investment choices, property syndications as a form of investment and recommends the investment to clients must be aware of the disclosures. In terms of the FAIS Code of Conduct the provider has an obligation to disclose material information to his or her client to enable the client to make an informed decision.

[34] The principle underlying the disclosures contained in Annexure A is set out in Clause 1 of the Gazette, thus:-

'Statements, presentations and descriptions shall not convey false or misleading information about public property syndication schemes and /or omit material information during the public offer of shares. Material information is information which an investor needs in order to make an informed decision.'

[35] Clause 2 further provides that promoters shall make available the prescribed information to investors who invest in or intend investing in public property syndication schemes. The prescribed information shall be

made available to investors and or potential investors in a disclosure document. The details to be disclosed are set out in Annexure A.

Clause 3 provides that anyone who does not comply with the requirements commits a criminal offence and shall be liable on conviction, to a fine not exceeding R200 000 or to imprisonment for a period not exceeding five years or to both the fine and imprisonment.

ANNEXURE A to the gazetted general notice sets out the minimum information to be contained in a property syndication disclosure document. It is the duty of an FSP to be familiar with these requirements before embarking on the promotion of any investment in property syndication.

- [36] Clause 1 contains a specific caveat that the investor shall be informed in writing that property syndication is a long term investment, usually not less than five years. The investor shall also be informed of the substantial risk he or she carries in that the investor may not be able to sell his share should he wish to do so in future. Sub clause (b) (iii) provides that 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. Clearly, access to funds in this type of investment is a material issue which ought to have been disclose to a complainant. On respondents own version, this was never disclosed to complainant.

[37] **Clause 2** deals with investor protection:

It provides: In addition to informing investors in writing that all funds received from them prior to the transfer/ finalisation shall be deposited into the trust account of a registered estate agent, a legal practitioner or a certified chartered accountant, it shall be clearly stated **who** controls the withdrawal of funds from the trust account.

In addition, it is provided in clause 2 that 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. Apart from being aware that funds were to be deposited into Du Toit Benidell attorneys' trust account, it didn't bother respondent that it did not know who controlled the withdrawals from the trust account. This, coupled with the fact that no clear track record was known of any of the persons behind the scheme in terms of how they deal with investor funds is critical in analysing risk to the investor. As it is in this case, the promoter controlled the withdrawals from the trust account. The latter, combined with the unlicensed status of the financial services provider, had the potential to produce disaster.

- [38] **Clause 2 (e)** also deals with disclosure of how any capital shortfall would be dealt with. On respondent's own version this aspect never formed part of the advice complainant received. It only learnt when making enquiries about the unpaid income that in fact only one of the intended properties was purchased which was also sold without the investors being informed. The reason furnished at the time is that the full syndicate value could not be met.
- [39] **Clause 3** provides that the disclosure document must also contain a statement by the promoter regarding amongst other things, the disclosure of proper due diligence (commercially and legally) with regard to the property and its tenants that the promoter has carried out, prior to the unconditional purchase of the property. The disclosure document is to be signed and dated by the promoter. Critical to the conduct of respondent is that it never called for the disclosure document mentioned in this clause, nor was any presented to it.
- [40] **Clause 4** deals with management. In addition to the full details of the syndication vehicle, the board of directors, the auditors, the attorneys and the valuer, a separate disclosure in relation to the fee structure of the management company or manager and any appointments or contracts relating to the syndication had to be made. Of the rentals collected and apart from any other reasonable expenses, there was a 5.75 % charge in

respect of management fees that had to be deducted by the managing agents, Hermas and Roman. Of the 5.75%, 2.5% would go to Blue Pointer and 3.25 % was retained by the agents. What is important here, is taking into account this expenditure together with any other foreseeable expenditure, the FSP is forced to do a reality check to see whether the projected returns are realistic. It is only with advice from a provider acting with due skill and diligence that a client would appreciate whether the attractive projected returns were not too good to be true.

[41] **Clause 5** deals with amongst others, the structure of the company, a disclosure as to whether a shareholders' agreement exists or not and that if the latter exists, it shall be attached as annexure to the disclosure document. Other details to be furnished are:

- The financial year end;
- The shares to be issues; the shares to be issued in future; control over the unissued shares; borrowing powers, shareholders' loans and or debentures; a pro-forma balance sheet on acquisition (in the case of new developments, on completion); the income distribution plan; minimum and maximum shareholder/ participation quota; any special voting rights; gearing; existing and or planned; borrowing powers and how they are to be exercised; external borrowing facilities available to investors to finance the acquisition of shares in the investment company; the amount provided in the syndication structure for working capital and reserves.

[42] On respondent's own version, these disclosures were not dealt with. The details are critical. As it is, several amounts were being paid by shareholders to the promoter without being aware of it. I am aware that compounding the problems at Blue Pointer was the fact that no proper books were maintained and no financial statements were made available.

[43] **Clause 6** deals with amongst other things, :-

- The cost of the property to the promoter or the syndication company including acquisition price;
- Cost of renovations, conversion or enhancement including details of any leases or lease renegotiations which enhance the value;
- marketing and promotional cost fees and the promoter's entrepreneurial mark up, giving rise to the shareholder offer price in the company as at the offer date and
- the valuation of the property as at a date, which shall not be more than three calendar months before date of the offer, undertaken by a valuer, in accordance with paragraph 10 of the Notice.

These details are necessary to enable any FSP to seriously consider whether there is any value for the investor. In addition, the FSP has the chance to consider the prudence with which the scheme is to be conducted by examining the add-ons to the acquisition price.

[44] **Clause 9** deals with projections. Full details for the basis used to calculate projections with regard to net income growth. These shall be based upon rental income derived from leases and or market rental growth, less specified and disclosed as well as reasonably expected expenses projections. The basis used to calculate projections on capital value. These may be stated in rand as estimates, provided they are accompanied by stated, specific assumptions showing how those values are determined. Specific projections as to capital growth are not permissible, bearing in mind the many variables influencing property values including a statement whether the validity of the assumptions used in determining projections is based on fact or opinion. The Notice specifically states, should a specific return be projected, it should be calculated with reference to the syndication value.

[45] **The syndication value** is the aggregate sum of the shareholders' total interest in the syndication vehicle in terms of the disclosure document, recognising that this sum includes an appropriate premium over and above the open market value of the property asset. The quantum of the premium is to be stated. In this case it was not disclosed. Evidenced by the blatant infractions of the Code, respondent violated the general duty as set out in Part II section 2.

Admittedly, none of these could have stopped the fraud that was going on at Blue Pointer, however, these provisions are designed to force the investor to not only look at the projected returns but the entire picture in order to understand what could potentially happen.

It was never the intention of the legislature that FSPs should merely comply with legislation. What was intended was for FSPs to apply their mind to the purpose of the legislation and to ensure, in dealing with members of the public that that purpose is achieved.

A typical example is annexure A to which I have just referred. Upon a proper reading of the general notice it amounts to a set of guidelines which FSPs may use in order to serve members of the public more responsibly. FSPs who ignore these guidelines do so at their peril. In this particular case, the respondent appears to have conducted this transaction in complete disregard of the recommended guidelines.

Conclusion

- [46] The duty placed on providers to act with due skill, care and diligence forces providers to take responsibility for the advice they provide to

investors. The fact that a client may have extra funds to invest based on his financial means, does not give license to any provider to act recklessly. In addition, advising a client to invest in a product which the provider does not understand and no appreciation of the risks involved is totally undesirable.

[47] Much has been written about risks associated with property syndication and the history we have in this regard in South Africa does not make for a pleasant read. Notwithstanding the giant steps taken in legislative measures, this area continues to be plagued by stories of investors having been robbed of their investment in the most crude and opportunistic fashion. Though avenues of exploiting the investor are still there, the requirements set out in the notice go a considerable way in addressing the much publicised gaps in public property syndications, namely:

- a) Excessive costs;
- b) Lack of visibility of enforcement mechanisms;
- c) Subsidisation of investors' expectations with loans;
- d) Poor governance and lack of transparency

In the case of Blue Pointer, added to these risks was the conduct of unlicensed business, culminating in what many would term, a disaster waiting to happen. Sometimes it is said, all that an investor is buying in a

property syndication are the promises made by the promoter. This is closer to the story of Blue Pointer.

- [48] It must not be forgotten that, all that the FAIS Act seeks to achieve is that consumers must make informed choices in concluding financial transactions. Hardly a stance one can describe as anti free market. To keep the economy going, businesses must make profits but this must be balanced with the enforcement of simple and meaningful disclosures to consumers. This protects the interests of the consumer and strengthens the integrity of the financial services.

Whether respondent's conduct caused complainant's damage?

- [49] Complainant has blamed respondent's superficial diligence as the cause of the damage he has suffered. Respondent has stated in its response that it is a combination of the conduct of the attorneys in whose trust account funds were deposited and the actions of Blue Pointer. I do not agree. There are two fundamental strokes in my view that weaken this argument. First, respondent themselves had no clue what they were doing in recommending the product to complainant. The crux of the matter lies in the fact that, had respondent known how to identify the risks involved in this particular product, it would have cautioned his client to look elsewhere for investment. Second, the erroneous assumption that Blue Pointer was

licensed without even a basic check of their license with the Financial Services Board was fatal. From here, it would have been reasonably easy for respondent or any reasonable provider to foresee the consequences of conducting unlicensed business as the persons behind the company have no accountability to anyone. The consequent theft of investors' funds and the shambolic state of the financial records would have been foreseeable.

Quantum of damages

[51] Complainant invested the amount of R495 000 on the understanding that he would, apart from the rental income, be paid his capital with growth at the end of the period of five years. Payments stopped in August 2007 and from that time, complainant has had neither his capital nor income payments. It would not be fair to grant complainant interest from date of this determination as the damage was always liquid. Respondent were placed in *mora* in August 2008 by complainant. Until now, no payment has been made to complainant.

Having come to the conclusion that respondent caused complainants loss, I make the following order:

[52] It is hereby ordered that:-

1. Respondent pay complainant the amount of R 495 000.00.
2. Respondent pay interest on the aforesaid sum at the rate of 15.5 % p.a. from the 30 of August 2008 to date of final payment.
3. Respondent pay the case fee of R1000.00 to this office within 30 days of date of this order.

DATED AT PRETORIA ON THIS THE 7th DAY OF JUNE 2010



NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS