OUR REFERENCE: FAIS 04525/11-12/ GP 1

22 December 2017

MR JHC VAN ZYL

HENDRIIK VAN ZYL FINANSIËLE DIENSTE (PTY) LTD

Per email: shortterm@hvzfindienste.co.za; dianne@hvzfindienste.co.za; hendrik@seesawelkom.co.za

Dear Mr Van Zyl,

Re: RECOMMENDATION IN TERMS OF SECTION 27 (5) (c) OF THE FAIS ACT 37 OF 2002: AMANDA KARVELAS v HENDRIK VAN ZYL FINANSIËLE DIENSTE (PTY) LTD and JOHANNES HENDRIK CONRADIE VAN ZYL

A. INTRODUCTION

1. During January 2008 the complainant, then aged 50, followed the advice of the second respondent and invested R400 000 in Sharemax Zambezi Retail Park Holdings Limited ("Zambezi Ltd"), a property syndication scheme promoted by Sharemax Investments (Pty) Ltd, (Sharemax). The funds invested were complainant's inheritance from her late husband, and were earmarked for her son's university fees.

2. The complainant initially received the monthly promised returns. However, around September 2010 the income suddenly stopped. The complainant made attempts to resolve the matter with the respondent, to no avail.

3. Despite the fact that the investment has reached its term, the complainant's capital has not been returned. The complainant was of the view that she has lost her capital and lodged the present complaint, requesting that the respondent be ordered to repay the capital amount.

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

B. THE PARTIES

4. The complainant is Mrs Amanda Karvelas, an adult female whose particulars are on file with this Office.

5. The first respondent is Hendrik van Zyl Finansiële Dienste (Pty) Ltd, a company duly incorporated and registered in terms of South African law, with registration number 1999/024582/07. The regulator's records confirm the first respondent's principal place of business as 424 State Way, Doorn, Welkom, 9459. The first respondent is an authorised financial services provider with licence number 14579. The licence has been active since 29 September 2004.

6. The second respondent is Johannes Hendrik Conradie van Zyl, an adult male, key individual and representative of the first respondent. The second respondent's address is the same as that of the first respondent.

7. At all materials times, the second respondent rendered financial services to the complainant.

8. I refer to the first and second respondents as "the respondent". Where appropriate, I specify which respondent is referred to.

C. DELAYS IN FINALISING COMPLAINTS OF THIS NATURE

9. In view of our mandate to resolve complaints expeditiously, among other demands posed by section 20 of the FAIS Act, it is important to address the delay in finalising the property syndication complaints involved in this matter. Sometime in September 2011, after the Office issued the *Barnes* determination[1], the respondent in that matter brought an urgent application to set aside the determination[2]. 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.

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

[2] The respondent claimed that section 27 of the FAIS Act was unconstitutional

10. Since no leg33al basis existed for the respondent's demands, the Office continued to determine further property-related complaints, to which the respondents reacted 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 in the original application, favouring the Office, was finally delivered in July 2012. See in this regard *Deeb Risk v FAIS Ombud & Others*[3].

11. The Office continued to determine complaints involving property syndications after the High Court decision. However, in 2013, and following the *Siegrist* and *Bekker* determinations[4] 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 2015[5], after which the Office resumed the processing of complaints that involved property syndications with due regard to the decision. As many as 2000 complaints had to be shelved pending the Appeals Board decision.

D. THE COMPLAINT

12. The second respondent was a trusted advisor to the complainant's late husband for more than 10 years. After the tragic loss of her husband following a home invasion, the complainant had no reservations about approaching the respondent for advice on how to best invest the money she inherited.

13. The complainant stated that her late husband had only one life policy (and no pension provision), which she utilised to settle his debt. An amount of R400 000 remained. It is this amount that complainant sought to invest to make provision for her son's university fees. The complainant was a teacher at the time and the sole breadwinner for her family. From the onset, she informed the respondent that she could not afford to lose her capital.

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3 Gauteng High Court Division, case number 50027/2014

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

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

14. The respondent assured complainant that her capital was guaranteed and a return of 10% per annum on the capital invested would be payable.

15. Complainant was forced to take extra work to supplement her monthly income and lapsed some of her financial arrangements with insurers as she could no longer afford them.

16. Complainant blames respondent for her losses because of the latter's failure to advise her of the risks involved in the investment. She asked this Office to order the respondent to repay her capital.

E. THE RESPONDENT'S VERSION

17. During November 2011, a notice in terms of rule 6 (b) was issued, referring the complaint to the respondent to resolve it with his client. The respondent's reply (which included a letter addressed to the complainant) is summarised as follows:

17.1 The respondent confirmed that he recommended the Sharemax investment to the complainant. When complainant met him, the funds were in a bank account generating very little interest and not sufficient to meet the complainant's needs. The complainant therefore had a "single need" and required no other service or analysis from the respondent.

17.2 The respondent indicated that he explained the content of the prospectus, and also highlighted the tax implications of the investment.

17.3 Because the complainant had reservations about the investment, she asked her own attorney to make enquiries about Sharemax. To this extent, Weavind & Weavind, the attorneys of Sharemax provided her attorneys with a letter[6].

17.4 The investment was performing well until the "unexpected" happened. The respondent is of the view that nobody could have foreseen that a company which complied with legislation and was a registered FSP would be prevented from trading.

[6] The letter briefly confirmed that Sharemax is an investment company which promotes property syndication schemes. Investors' fund would be paid into the trust account and protected by the Attorneys Fidelity Fund. Upon registration of transfer of the said property in the name of the company noted in the prospectus, a share certificate is issued to the investor.

17.5 In closing, the respondent relied on the scheme of arrangements which was confirmed by the Court at the time and which allegedly reinstated the "worthless" share certificates.

18. During August 2012 and June 2015 respectively, the Office addressed correspondence to the respondent in terms of Section 27 (4) of the FAIS Act, informing the respondent that the complaint had not been resolved and that this Office had the intention of investigating the matter. The respondent was invited to provide the Office with his case, including supporting documents, in order for the Office to begin its investigation. No reply was received.

F. INVESTIGATION

19. On 8 November 2017, the respondent was provided with a further opportunity to address the Office in terms of section 27 (4) of the FAIS Act. The specific questions raised (omitting words not essential) are set out below:

- *Property syndications are high-risk investments for a number of reasons amongst which are, the complicated structure and the nature of the investment (being unlisted securities). Being unlisted means that there is a lack of regulatory oversight over these investments. Investors are at risk as unlisted shares and debentures are not readily marketable and the value is also not ascertainable. Should the company fail, this may result in the loss of the investor's entire investment. Was this explained to the complainant?*

- *The basis upon which the properties are valued are never fully disclosed. Did you confirm the valuation figures shown in the prospectus with the cited property valuer?*

- *The prospectus of Zambezi Retail Park makes it plain that Sharemax was the promoter, the company secretary, property manager and makes no mention of an independent fund manager. Given the overwhelming conflict of interests, what steps did you take to ensure that your client would not be short changed by the directors of the syndication?*

- *The prospectus further informs potential investors that, essentially, no independent board of directors exists. There is a clause stipulating that a new board will be elected on the first meeting of shareholders; however, there is no evidence that the election occurred. Given that there was no independent board of directors (as provided for in the King reports), what steps*

did you take to satisfy yourself that your clients would be protected against director misconduct?

- *Given the absence of an independent board, how were you going to ensure that investor funds would be used for what they were meant for and within proper governance prescripts?*

- *You should be aware that the oversight of a board includes the appointment of an audit committee whose function, among other things, is to receive assurance from an independent audit firm. An audit committee's oversight includes satisfying itself that the entity has proper controls, and that the information contained in the financial statements of the entity can be relied on. Given the fact that there was no audit committee and no audited financial statements, what information did you take into account to conclude that the investment was viable?*

- *Government Notice 459 of Gazette 28690 mandates that investor funds are to be kept in a trust account until registration of transfer into the name of the syndication vehicle or upon agreement with an underwriter, whose name must be made public. Given that the prospectus makes it clear that investors' funds will be withdrawn to fund various activities, what made you recommend the product to your client, in the face of this high risk?*

- *What information did you rely on to conclude that this investment was appropriate to your client's risk profile and financial needs? In this regard your attention is drawn to the provisions of section 8 and 9 of the General Code.*

20. The respondent again failed to reply to the said notice.

G. ANALYSIS

21. The respondent did not deny that he had an agreement with the complainant in terms of which he rendered financial services to her. The specific form of financial service that this complaint is concerned with is advice[7]. That advice, undoubtedly, had to meet the standard prescribed in the General Code. That the complainant acted on this advice has not been denied by respondent.

[7] The definition of a financial service in section 1 includes an intermediary service.

The law

22. The following sections of the General Code of Conduct are relative to the issue of advice:

22.1 Section 2, part II of 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.

22.2 Section 3 (1) (a) of the Code states that when a provider renders a financial service, that:

(a) representations made and information provided to a client by the provider –

(i) must be factually correct;

(ii) must be provided in plain language, avoid uncertainty or confusion and not be misleading;

(iii) must be adequate and appropriate in the circumstances of the particular financial service, taking into account the factually established or reasonably assumed level of knowledge of the client;

(iv) must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction.

22.3 Section 7 (1) 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.

22.4 Section 8 (1) (a) to (d) 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…

22.5 Lastly, section 9 provides for the keeping of a record of advice which must reflect the following:

(a) a brief summary of the information and material on which the advice was based;

(b) the financial product [sic] which were considered;

(c) the financial product or products recommended with an explanation of why the product or products selected, is or are likely to satisfy the client's identified needs and objectives; and

(d) where the financial product or products recommended is a replacement product as contemplated in section 8(1)(d) –

(aa) the comparison of fees, charges, special terms and conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided, between the terminated product and the replacement product; and

(bb) the reasons why the replacement product was considered to be more suitable to the client's needs than retaining or modifying the terminated product…

23. The questions posed in the notices in terms of section 27 (4) sent by this Office to the respondent had their answers grounded in the prospectus. Had the respondent paid attention to the prospectus, he would have understood that the investment was not suitable for his client. To this extent, I refer to the attached summary of the Zambezi prospectus, the Sale of Business Agreement, (SBA) and Government Notice 459 (Notice 459), as published in Government Gazette 28690.

Zambezi Ltd prospectus

Conflicting provisions of the prospectus

24. From the onset, the prospectus declared that the directors of Sharemax (the promoter) had no intention to comply with Notice 459. To illustrate this point, I refer to paragraph 19.10 of the prospectus, which states that funds collected from investors would remain in the trust account and

investors would be paid their return from the interest accumulated therefrom. Paragraph 5.11.2 on the other hand, states that the funds would not remain in the trust account long enough, since 10% would be released after the cooling-off period of seven days to pay commissions[8]. Paragraph 4.3 confirmed that funds would be advanced to the developer in terms of the SBA via the sister company, Zambezi (Pty) Ltd. These payments were in violation of the Notice, section 2 (b) which states 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".

25. Two problems arise with the proposition that the investor's return would be paid from the interest generated by the trust account:

25.1 At the time interest payable by the bank on investments made in line with section 78 (2A) did not go beyond one digit. In fact, this office obtained information that the interest payable at the time was between 7.4% and 8.6%[9]. Sharemax promised 10%.

25.2 The prospectus is unequivocal that the funds would not stay in the trust account long enough to have accumulated any significant interest because of the withdrawals to fund commissions and, subsequently, to fund the acquisition of the immovable property.

26. The prospectuses issued by The Villa Ltd[10] and Zambezi Ltd refer to an SBA[11] concluded between Zambezi (Pty) Ltd and the developer Capicol in respect of Zambezi Ltd and Capicol 1 in respect of The Villa. Two types of payments are dealt with in the SBA: payments to the developer, and to an agent called Brandberg Konsultante (Pty) Ltd. (Brandberg).

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8 The aforesaid is confirmed in the investment application forms completed by the complainant.

9 http://www.fidfund.co.za/wp-content/uploads/2016/03/Historical-Credit-Interest-Rates-from-30-01-2014.pdf

10 Another property syndication scheme promoted by Sharemax

11 Note that the SBA in respect of both entities, Zambezi (Pty) Ltd and The Villa (Pty) Ltd carried essentially the same terms but differed in terms of amounts. The developer, however, **was Capicol 1 in respect of Zambezi and Capicol in respect of The Villa**. Both the borrowers and lenders were represented by the same persons.

Payments to Capicol[12]

27. According to the agreement, investors' funds were moved from Zambezi Ltd to Zambezi (Pty) Ltd and advanced to the developer of the shopping mall. At the time of releasing the Zambezi Ltd prospectus, Sharemax had already advanced substantial amounts to the developer in line with this agreement. A brief analysis of the SBA reveals:

27.1 No security existed for the loan; this is clear from reading the prospectus and the agreement.

27.2 The prospectus stated that the asset was acquired as a going concern, however, the building was still in its early stages of development.

27.3 At the time the funds were advanced to the developer, the immovable property was still registered in the name of the developer. Although the prospectus mentioned the intention to register a mortgage loan, there is no evidence that this was done.

27.4 The developer paid interest of 14%, from which Sharemax took 2% and paid the remaining 12% to the investors of Zambezi.

27.5 The agreement is devoid of detail relating to the assessment of the developer's credit worthiness. There was no evidence that the developer had independent funds from which it was paying interest. Besides, if the developer had the financial standing to borrow such large sums of money at 14% per annum, it would have gone to mainstream commercial sources.

27.6 No detail is provided to demonstrate that the directors of Zambezi had any concerns about the Notice 459 violations.

27.7 There are no details regarding the economic activity that generated the 14% return paid by the developer.

28. The only rational conclusion is that the interest paid to investors came from their own capital.

[12] (Capicol 1 in the case of The Villa (Pty) Ltd)

Payments to Brandberg

29. An entity known as Brandberg was paid commission in advance. According to the SBA, the commission had been calculated at 3% of the purchase price. There are no details of how these payments benefited investors. No valid business case is made as to why commission had to be advanced, in light of the risk to investors. No security was provided against this advance to protect the investors' interests.

30. The payments to Capicol and Brandberg were in violation of Notice 459. These are serious red flags (as comprehensively noted in the annexures) that were apparent from the start and should have led a reasonable person, particularly one in the position of the respondent, to foresee the harm and take steps to mitigate it accordingly[13].

The Code

31. What is clear from the aforesaid information is that the respondent was out of his depth when he recommended the Sharemax investment to his client. The mere fact that the respondent was prepared to confirm in writing that the capital was guaranteed, despite the warnings contained in the prospectus, is confirmation that he did not understand the intricacies of the investment. In this respect, the respondent's advice was negligent and in violation of his duty as set out in section 2 of the General Code (the Code). The respondent could therefore not advise his client appropriately, in contravention of sections 3 (1) (a) (i) – (iii) and 8 (1) (a) to (c) of the Code.

32. From the information provided and the lack of relevant records, it is evident that the respondent paid no attention to his client's personal circumstances when he considered the suitability of the Sharemax investment. The respondent was well aware of the complainants' financial status; specifically, she was the sole breadwinner. Despite the aforesaid, the respondent still considered the investment in Sharemax to be appropriate. There was no consideration of other products, and no justification or explanation in terms of section 9 of the Code as to why the Sharemax investment prevailed.

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[13] *Van Wyk v Lewis, Durr v ABSA*, case number 424/96, SCA

33. Section 7 (1) 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 a full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision.* The probability favours the complainant's version that she was not advised of the risk involved in the product, and more so, because the respondent himself did not understand the risks.

H. CAUSATION

34. The respondent had a duty to advise his clients that:

34.1 the product was high risk and not suitable for her;

34.2 information provided in the prospectus was conclusive about the investors carrying all the risk;

34.3 the prospectus undermined the provisions of Notice 459, the very legal measures that are designed for the protection of the investors;

34.4 there were significant and apparent governance flaws, which pointed to the fact that investors would have no protection from the onset; and,

34.5 collectively, the above-mentioned concerns presented compelling reasons to suggest that the complainant could lose her capital. The respondent has provided no evidence to this Office that he discharged any of the duties provided in sub paragraphs 34.1 to 34.5.

35. I conclude that it was the respondent's inappropriate advice that caused the complainant's loss. Had the respondent adhered to the Code, no investment would have been made in Sharemax.

I. FINDINGS

36. The respondent failed to appropriately advise his client in violation of sections 2, 3 (1) (a) (vii), 7 (1), 8 (1) (a) to (c), and 8 (2).

37. As a consequence of the breach of the Code, the respondent committed a breach of his agreement with the complainant in that he failed to provide suitable advice. The respondent must have known

that the complainant would rely on his advice as a professional in effecting the investment in Sharemax.

38. It stands to reason that the respondent caused the complainant's loss.

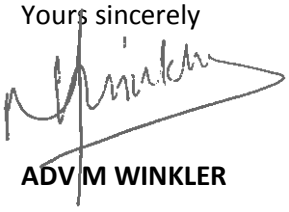
J. RECOMMENDATION

39. The FAIS Ombud recommends that the respondent pay the complainant the amount of R400 000.

40. The respondents are invited to revert to this Office within TEN (10) working days with their response to this recommendation. Failure to respond will result in a determination being made in terms of Section 28 (1) of the FAIS Act[14].

41. The complainant, upon full payment, must cede all her rights and title to the investment to the respondent.

Yours sincerely



ADV M WINKLER

ASSISTANT OMBUD

[14] "*The Ombud must, in any case where a matter has not been settled or a recommendation referred to in section 27(5)(c) has not been accepted by all parties concerned, make a final determination, which may include-*
(a) the dismissal of the complaint; or
(b) the upholding of the complaint, wholly or partially…."