Parliamentary Joint Committee on Corporations and Financial Services

Property Investment Advice – Safe as Houses?

June 2005

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DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the duties of the committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

TERMS OF REFERENCE

On 8 December 2004, the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into the regulation of property investment advice by the Commonwealth, with reference to:

(a) the effectiveness of current regulation (including the *Trade Practices Act 1974*, the *ASIC Act* and the *Corporations Act 2001*) of the property investment advice industry in protecting consumers;

(b) allegations that property investment advisers engage in behaviour including:

   i. characterisation of their activities (for instance, as "education seminars") in order to avoid regulation;

   ii. habitual use of high pressure selling techniques in order to induce investment decisions;

   iii. failure to disclose interests they may have in properties they are selling;

   iv. failure to disclose commissions and fees associated with their services; and

   v. failure to provide appropriate disclosure of downside risk associated with the property or financial products they recommend;

(c) whether it is appropriate for property investment advisers to simultaneously sell an interest in property and financial products enabling such purchases;

(d) advantages and disadvantages of possible models for reform of the property investment advice industry including:

   i. national coverage through uniform state and territory legislation;

   ii. Commonwealth legislation; and

   iii. a scheme of self-regulation of property investment advisers on a national basis; and

(e) whether current legal processes provide effective and easily accessible remedies to consumers in dispute with property investment advisers.

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CHAPTER 1

Introduction

Background

1.1 On 8 December 2004, the Parliamentary Joint Committee on Corporations and Financial Services adopted terms of reference for an inquiry into the regulation of property investment advice by the Commonwealth for inquiry and report by 23 June 2005.

1.2 The terms of reference for the inquiry are:

The Committee will inquire into the regulation of property investment advice by the Commonwealth, with reference to:

(a) the effectiveness of current regulation (including the *Trade Practices Act 1974*, the *ASIC Act* and the *Corporations Act 2001*) of the property investment advice industry in protecting consumers;

(b) allegations that property investment advisers engage in behaviour including:

  (i) characterisation of their activities (for instance, as "education seminars") in order to avoid regulation;

  (ii) habitual use of high pressure selling techniques in order to induce investment decisions;

  (iii) failure to disclose interests they may have in properties they are selling;

  (iv) failure to disclose commissions and fees associated with their services; and

  (v) failure to provide appropriate disclosure of downside risk associated with the property or financial products they recommend;

(c) whether it is appropriate for property investment advisers to simultaneously sell an interest in property and financial products enabling such purchases;

(d) advantages and disadvantages of possible models for reform of the property investment advice industry including:

  (i) national coverage through uniform state and territory legislation;

  (ii) Commonwealth legislation; and

  (iii) a scheme of self-regulation of property investment advisers on a national basis; and

(e) whether current legal processes provide effective and easily accessible remedies to consumers in dispute with property investment advisers.

1.3 The Committee took the view that it was not its role in this inquiry to address individual cases involving consumers but rather to examine the overall regulatory scheme relating to the property investment advice industry. However, the Committee did take individual cases into account to the extent to which they provided illustrative examples of evidence provided to it.

1.4 The Committee is aware that the Ministerial Council on Consumer Affairs (MCCA) established a working party on property investment advice and released a discussion paper in August 2004. While the Committee understood that it was likely that there would be some parallels between the MCCA working party's examination of the property investment advice industry and this inquiry, the Committee expected to make a number of distinct contributions, including:

- examining the issue from a slightly different perspective to the MCCA (which approached the issue from a consumer affairs perspective – although informed by broader considerations of efficiently functioning financial markets);
- conducting a more public process than the MCCA (the MCCA did not release its submissions publicly);
- assisting the MCCA's consideration of the issue; and
- assisting the Commonwealth Government and the Parliament in considering any Commonwealth role or contribution suggested by the MCCA through the Council of Australian Governments.

Conduct of the inquiry

1.5 The Committee advertised the inquiry in *The Australian* newspaper, and details of the inquiry were placed on the Committee's website. The Committee also wrote to a number of organisations and individuals alerting them to the inquiry and inviting them to make a submission.

1.6 The Committee received 26 submissions, and these are listed at Appendix 1. Submissions were placed on the Committee's website.

1.7 The Committee held public hearings on the Gold Coast on 13 April 2005, in Sydney on 15 April 2005, and in Canberra on 28 and 29 April 2005. A list of witnesses who appeared before the Committee at each hearing is listed at Appendix 2. Copies of the Hansard transcript are available through the Internet at http://www.aph.gov.au/hansard.

CHAPTER 2

Key Issues

The key issues

2.1 The boom in real estate and the large amounts of money involved in property investment attracted a number of unscrupulous operators, promoters and marketeers (generically called 'property spruikers' in this report) to the detriment of large numbers of consumers, and to the detriment of honest property investment advisers who lost potential business.

2.2 Significant problems associated with the provision of property investment advice and wealth creation training services in Australia today include:

- the variable quality of advice services, including concerns about the appropriateness, feasibility and, in some cases legal or ethical character of recommended investment strategies;
- the lack of disclosure of commissions and arrangements and relationships which promoters have with property developments;
- the lack of opportunity for consumers to have their questions answered, and to thoroughly consider a possible investment;
- misrepresentations that proposed investment strategies are risk-free or very low risk; and
- failure to provide promised refunds on seminars and courses and the difficulties consumers experience in obtaining redress.[1]

2.3 The key issue of this Inquiry is how to create a regulatory regime which takes reasonable steps to protect consumers from the operations of property spruikers and other get-rich-quick promoters, or, at the very least, establishes significant barriers to entry into this industry.

2.4 Property spruikers use a number of marketing tools, the most prominent of which in recent years has been the "wealth creation seminar", sometimes disguised as an "education program". Characteristics of their operations, generally, are:

- they target the financially vulnerable and unsophisticated;
- they use high pressure selling techniques;

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1 Property Investment Advice Discussion Paper, Ministerial Council on Consumer Affairs Working Party, August 2004, p. 5. The Australian Consumers' Association listed a similar range of concerns – see *Transcript of evidence*, 15 April 2005, pp. 37 & 38.

- they promise much more than they can deliver;
- they involve undisclosed conflicts of interest; and
- they cost exorbitant amounts of money for what they provide.

2.5 Property spruikers have attracted considerable public interest particularly in times of booming property values, as experienced in most Australian cities in recent years. Precise numbers are not available, but it appears likely that many thousands of consumers have participated in these dubious schemes.[2]

2.6 As well as promoting the direct purchase of real estate, spruikers have also promoted other schemes such as the provision of funds to developers seeking additional capital, and the sale of educational, training and motivational courses and materials of the "*How to be a property millionaire"* type.

2.7 In August 2004 the Ministerial Council on Consumer Affairs (MCCA) released a comprehensive discussion paper on the issue of property investment advice, and invited submissions from interested parties. The Committee considered the MCCA discussion paper to be a good foundation for national policymaking on this issue, and decided to hold its own public inquiry into the regulation of property investment advice.

2.8 The MCCA discussion paper defines "advice" as broadly including information, opinions and recommendations where the adviser has a vested interest in, or hopes to obtain financial or other gain as a result of their recommendations, as well as the situation where the advice given can be described as genuinely independent or disinterested.[3]

2.9 As defined, advice about various aspects of property investment can be provided by a wide range of individuals and businesses, including real estate agents, property investment advisers such as buyers' agents, property developers and their sales consultants, financial planners, mortgage brokers, bankers and other lenders, accountants, lawyers, seminar operators and wealth creation promoters.

2.10 The Real Estate Institute of Australia (REIA) asserts that an important part of the issue is that property spruikers are not licensed real estate agents or certified salespeople and so have had no relevant training.[4] However, the Committee heard other evidence that suggested property spruikers often have a real estate background.[5]

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2 According to some estimates possibly as many as 100,000 consumers may have attended seminars run by spruikers during the height of the recent property boom in 2001-03. MCCA Discussion Paper, August 2004, p. 19.

3 MCCA Discussion Paper, August 2004, p. 3.

4 Ms Verhoeven, *Transcript of evidence*, 28 April 2005, p. 7.

5 For example, The Investors Club, *Submission 10*, p. 2; The Australian College of Financial Services, *Submission 2*, p. 6.

Why is property investment advice important?

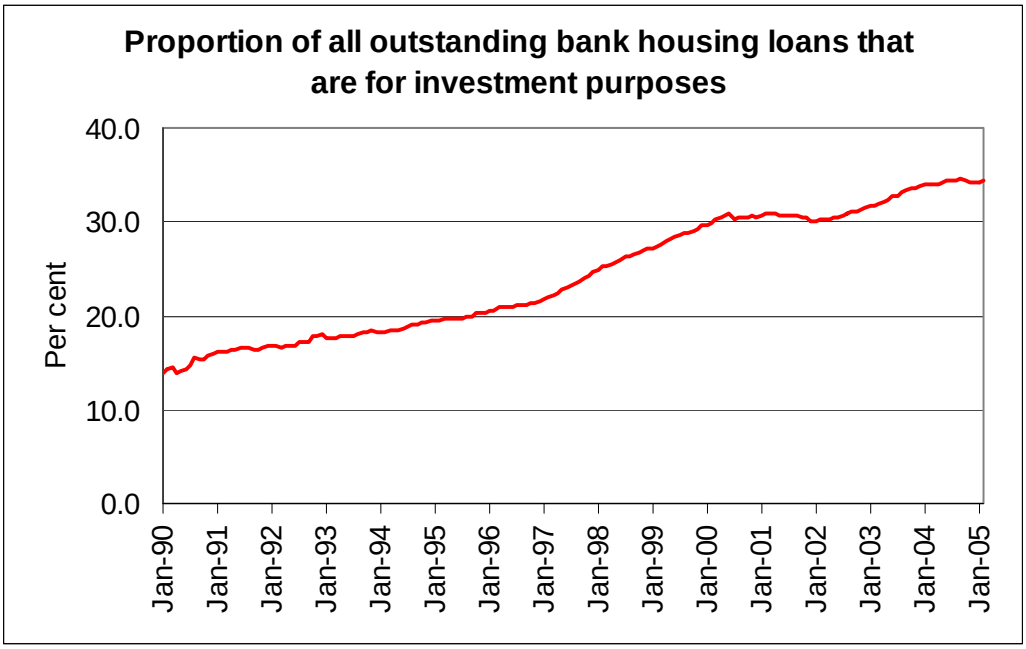
2.11 Australians have always had a high rate of home-ownership, and 'bricks and mortar' are also favoured for investment:

> … the average Australian investor has more money tied up in directly held real estate investments than in directly held sharemarket investments.[6]

2.12 Australia's rate of home ownership is similar to some comparable countries, but it has a much higher rate of ownership of investment property. For example, about 70% of homes in Australia are owned or being purchased, compared with 69% in the United Kingdom, 67% in the United States and 64% in Canada. However, with regard to investment property, about 13% of Australian households receive rental income (up from about 9% a decade ago), compared with about 6.5% in both the USA and Canada, and 2% in the UK.[7]

2.13 The continuing enthusiasm of Australians for property investment is shown in Figure 1. Investment loans as a proportion of total outstanding housing loans have grown from around 15% in 1990 to about 34% in 2005.

Fig.1: Proportion of bank housing loans for investment purposes



Source: Reserve Bank of Australia Bulletins.

6 MCCA Discussion Paper, August 2004, p. 9.

7 *First Home Ownership*, Productivity Commission Inquiry Report No. 28, March 2004, pp. 22 & 33. According to the Australian Taxation Office's *Taxation Statistics* in 2001-02 there were 10,280,299 taxpayers of whom 1,337,520 (13%) received rental income.

2.14 Property is a very substantial part of the Australian economy. According to the submission from the REIA in the financial year 2002-03 property sales had a total value of $156 billion.[8] A significant proportion of Australians - estimated at 22% - rely for their housing on rental accommodation provided by private landlords.

2.15 The increasing interest in property investment is probably due to a combination of a number of factors such as the desire of investors to share in the significant capital gains made in the residential property market in recent years, the volatility of share markets, the collapse of major public companies such as Ansett and HIH, disappointing returns of superannuation funds, the availability of investment finance at relatively low rates of interest, greater variety of financing options[9], favourable taxation treatment; and the growing realisation that people must provide for themselves in retirement.

2.16 The vigorous marketing of property for investment in recent years (particularly off-the-plan sales and related financial products such as deposit bonds), has also no doubt contributed to generating greater public interest in this investment class.

2.17 Property is a very important asset class in Australia, yet the Committee found that the property investment advice profession seems poorly organised and developed when compared with other areas of investment advice such as, for example, the financial planning profession or stockbroking.

2.18 The Committee received evidence that suggested that Australians, perhaps as a result of their direct experience of home ownership, feel that they understand investing in 'bricks and mortar' and that it is somehow easier and safer than investing in other asset classes.[10]

2.19 Unfortunately many consumers have learnt, to their cost, that investment in property can be a complex matter, with considerable risks for the uninitiated. The amounts involved are usually relatively large, with significant entry and exit costs, and the risks involved in using some of the new financing options, such as utilising the equity in the family home, need to be well understood.

2.20 Professional property investment advice, personally delivered, is difficult to find although the REIA made the point that there are now many magazines and books on the market which provide advice on investment, including in property.[11]

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8 REIA, *Submission 4*, p. 2.

9 According to the Australian Bankers Association the number of housing loan products available to borrowers has more than doubled since 1996, with many new products designed specifically for property investors. MCCA Discussion Paper, August 2004, p. 10.

10 See, for example, Griffith University, *Submission 13*.

11 Mr Stevens, *Transcript of evidence*, 28 April 2005, p. 8.

2.21 Financial planners generally recommend managed investments to their clients as they derive their income from fees and trailing commissions. Mr J Hopkins of the Property Investment Association of Australia (PIAA) estimates that 'less than 1% of financial planners involve themselves in direct investment in property'.[12] The Financial Planning Association of Australia (FPA) admitted that 'Institutional licensees tend to prohibit recommending any direct property … it is just too hard to monitor and control'.[13]

2.22 There is a small but growing sub-sector of the real estate industry which services investors interested in acquiring property. They are known as 'buyers' agents'.[14]

2.23 Buyers' agents appear to operate under a normal real estate agents licence, although their focus is on buying rather than selling property. While their business is helping buyers source investment property, they usually still obtain their fee or commission from the vendor.[15]

2.24 When the Committee pointed out that this seemed a conflict of interest, Mr Allen representing The Investors Club, who act as an agent for buyers, admitted that this was a dilemma for them. However, The Investors Club claims that its members/buyers pay no more than they would if purchasing the same property through a normal real estate agent—the vendor still pays a selling commission, but instead of paying it to his own agent the money is paid to the buyer's agent. Furthermore, in contrast with a normal real estate agent, The Investors Club says that it continues to provide its members/clients with a range of services after settlement takes place.[16]

2.25 In Australia, real estate agents have traditionally been paid by vendors.[17] Property buyers do not expect to pay for marketing or sales services related to real estate purchases, including property investment advice. That is why buyers' agents normally get their commissions from vendors even though they represent the buyer (i.e. their commission is built into the final selling price).

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12 Mr Hopkins, *Transcript of evidence*, 13 April 2005, p. 6.

13 Mr Graham, *Transcript of evidence*, 15 April 2005, p. 12.

14 Two witnesses who operate as buyers agents appeared separately before the Committee on 13 April 2005, Mr John Hopkins and Mr John Allen. The REIA told the Committee that there are about 40,000 buyers agents operating in the USA today. Mr Stevens, *Transcript of evidence*, 28 April 2005, p. 13.

15 Some buyers agents, such as Morell & Koren, do charge the purchaser directly.

16 Mr Allen, *Transcript of evidence*, 13 April 2005, pp. 31-32 and 37-38.

17 In contrast the Committee heard evidence from Mr R. Bobb, representing the Accounting Bodies, that in Hong Kong vendors and purchasers both pay real estate agents a standard 1%. *Transcript of evidence*, 29 April 2005 p. 30. Mr V Mangioni of UTS says that NSW legislation now prohibits an agent from acting for a buyer and seller of the same property, and recommends a similar provision be included in the Corporations Act. *Submission 25*, p. 1.

2.26 The REIA noted that buyers' agents 'are covered under the real estate legislation in each of the states and territories, with provisions for disclosure of any beneficial interest in properties, and also for cooling-off periods, which now exist in seven of the eight jurisdictions'.[18] However, buyers' agents often appear to provide investment advice, and the Committee was not convinced by the REIA's contention that buyers' agents are adequately regulated under present arrangements.

2.27 The booming property market and the fairly recent emergence of buyers' agents perhaps go some way towards explaining why property spruikers have succeeded in attracting such big audiences – potential investors want to know more about this important asset class, but there have been relatively few sources of recognised and readily-accessible information. So they turn to high-profile, apparently successful and very persuasive, property spruikers.

2.28 The Australian Consumers' Association (ACA) commented:

> … there is strong pressure on consumers generally to provide for themselves financially in order to secure their future financial wealth, and particularly on those people approaching retirement. That is a very strong driver for people to attend these sorts of seminars and seek out financial information and investment advice wherever they can find it.
>
> The reality is that these seminars are one of the few free mechanisms by which consumers access financial advice, and therefore it is little wonder they are drawn to them, not only by the promises of easy wealth but also because it is free for them to attend, certainly in the initial stage.[19]

2.29 The submission from Mr Vincent Mangioni of the University of Technology Sydney suggested that, to meet consumer needs, universities could develop and conduct property investment seminars.[20]

2.30 There is every indication that the interest of ordinary Australians in investing in property will continue to grow in the future. The Committee would like to see consumers provided with the best possible advice in relation to investment in this very important asset class, particularly so that the consumers are able to adequately weigh up the prospects for return on investment as against other asset classes available to investors.

2.31 This is particularly important with the retirement of the 'baby boomers' and the large amounts of superannuation money which they will have to invest. While the advent of superannuation choice on 1 July 2005 could provide consumers with more investment options, the submission from the Real Estate Consumer Association (RECA) warned of possible dangers:

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18 Ms Verhoeven, *Transcript of evidence*, 28 April 2005, p. 14.

19 Ms Wolthuizen, *Transcript of evidence*, 15 April 2005, p. 39. It should be noted, of course, that in most cases only the initial recruitment seminar is free.

20 RECA, *Submission 25*, p. 4.

> With Super Choice almost ready to make its debut on the Australian financial markets, consumers will be incredibly vulnerable to a greater number of complex sophisticated scams without a properly constituted consumer protection agency ready to do whatever it takes to protect consumer interests.[21]

2.32 The property investment advisory industry is still in a formative stage and there has been no specialist industry association to develop codes of conduct and training courses such as exist, for example, for the financial planning profession. The submission from the Australian College of Financial Services (ACFS) reported that the Association of Financial Advisers recently adopted investment property advising as one of its disciplines, and has compiled a professional standard in that regard.[22] The submission from the fledgling PIAA indicates that an attempt to establish a specialist association for companies and individuals operating in the property investment industry is being made.[23]

2.33 The submission from Australian Property Systems makes the point that financial planners should provide their clients with advice covering all asset classes, based on the principle of balanced and diversified portfolios. However in practice financial planners focus on managed investments. Similarly, real estate agents and property marketing groups only recommend investment in property (and their advice is subject to various conflicts of interest). The submission argues that the solution is to include real property under FSR which will encourage all investment advisers to develop a good understanding of all asset classes.[24]

2.34 Given the public's obvious appetite for property investment, the Committee would ideally like to see the situation where all investment advisers, including financial planners, can provide professional advice on all asset classes, including real property. Until that ideal situation is achieved, there is obviously a need for a much better organised and properly trained group of advisers who can provide good advice on property investment. Chapter 3 of this report proposes new regulatory measures which, while providing some protection against property spruiking, also support the development of a legitimate, professional property investment advice industry.

How spruikers operate

2.35 The Committee received evidence outlining the normal *modus operandi* of property spruikers. Characteristics of their behaviour are:

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21 ACFS, *Submission 25*, p. 67.

22 ACFS, *Submission 2*, pp. 11 & 12.

23 PIAA, *Submission 5*, and *Transcript of evidence*, 13 April 2005, pp. 1-19.

24 APS, *Submission 3*, pp. 3 & 4.

- Spruikers allegedly often characterise their wealth creation seminars as educational seminars rather than as financial advice in order to avoid the regulatory requirements attracted by the provision of financial advice for a fee. In addition, by promoting a strategy rather than a particular investment, they argue that their activities are distinct from financial advice.
- Spruikers appear to use high-pressure, high-energy selling techniques in order to rush consumers into a decision without allowing them to give the decision adequate consideration. Subtle intimidation may also be used. In short, this is old fashioned hustling.
- Spruikers who do suggest specific investment opportunities are allegedly often paid a commission to promote those products. This provides an obvious conflict underlying the quality of information provided to consumers. This conflict is seldom if ever disclosed.
- Spruikers often supplement their incomes by obtaining fees and commissions from other sources (such as a "spotters fee" for finding particular properties). These fees are allegedly not disclosed appropriately.
- Spruikers allegedly either completely fail to discuss downside risks to the investments they promote, or aggressively downplay those risks.

2.36 RECA described typical spruiker activity as follows:

> Consumers believe they are firstly purchasing an education course on money and investment strategies, how to manage risk, how to use stock market strategies AND, on how profits from the first year of the activity will pay for the extravagant course fees. People flock to learn how this is done under the mistaken belief promoted by the Group, that this is all Government Approved. Fear tactics are used to entice people to sign for a *"on-the-night only discount offer, sweetened by a money back guarantee"*…The whole structure is a con.[25]

2.37 The Committee is concerned that property spruikers often function both as property advisers and as credit brokers, arranging credit either for investment, or to pay for further "training".

2.38 For instance, spruikers may offer a "free introductory seminar" the purpose of which is to encourage people to enrol in the more expensive, substantive courses. Some spruikers offer personal loans or other credit facilities in order to "assist" consumers to afford these enrolment fees. Others offer to arrange financing for actual property purchases, including "vendor financing" and "deposit bond" arrangements where the borrower can be exposed to large financial risks, most of which are allegedly not adequately explained.

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25 RECA, *Submission 26*, p. 66.

Why are spruikers able to operate?

2.39 Property spruikers appear to have been able to operate because the regulatory regime which governs property investment advice is not well defined. This is in contrast to investment advice on financial products, where the regulatory regime is very clearly defined.

2.40 The general consumer protection laws of the Commonwealth and States and Territories (including the Commonwealth *Trade Practices Act 1974*) are currently the principal laws regulating property and property investment advice.[26]

2.41 Only Queensland has introduced specific regulations relating to "property marketeers". A marketeer is defined as anyone directly or indirectly involved in any way in the sale or promotion of residential property, or the provision of a service in connection with a sale. This wide definition was meant to capture those on the periphery of the real estate industry who claimed that their promotional activities did not make them subject to the normal real estate laws.

2.42 The Queensland marketeer provisions prohibit misleading and deceptive conduct and false representations and various forms of offensive behaviour by marketeers in relation to the sale of residential property in Queensland.[27] However, while this law may have curtailed some of the excessive behaviour taking place in Queensland, the submission from Griffith University commented:

> These provisions do not provide adequate consumer protection because of, in particular, their lack of licensing requirements and associated obligations.[28]

2.43 Other laws which may be relevant to aspects of property investment advice include State and Territory real estate and consumer credit laws — but these typically deal with operational issues rather than the provision of advice — and the Commonwealth *Corporations Act 2001* which regulates, under Financial Services Reform (FSR)[29], advice on financial products. But real property is not considered to be a financial product, so advice related to investment in real property is excluded from the financial services laws.

2.44 The MCCA discussion paper provides the following 'formal' explanation for the exclusion of real property from FSR. With financial products (securities,

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26 The *ASIC Act 2001* 'mirrors' the TPA in relation to financial products.

27 MCCA Discussion Paper, August 2004, pp. 29 & 30. *Property Agents and Motor Dealers Act 2000 (Qld)*, Chapters 16 & 17.

28 Griffith University, *Submission 13*, p. 6.

29 The *Corporations Act 2001*, as amended by the *Financial Services Reform Act 2001*, took effect on 11 March 2004.

derivatives, interests in superannuation funds and managed investment schemes, debentures, bonds etc) an investor surrenders day-to-day control of an amount of money or money's worth to another person who uses, or is intended to use, that money to generate a financial return for the investor. With direct investment in property, on the other hand, while the property itself may generate a return, it is not a return generated by the use of the investor's money by another person. [30]

2.45 Under this definition a clear distinction can be made between direct investment in property and investment in a property trust or managed investment. The latter form of investment is included under FSR as day-to-day control of the investor's funds is surrendered to a third person.

2.46 FSR may apply to a seminar presentation on property investment if, for example, the seminar presenter offers advice on shares as well as property, or if returns from property investment are compared with other asset classes, or if there is a discussion of credit or financing options.

2.47 The Australian Consumer and Competition Commission (ACCC) is the Commonwealth agency with responsibility for administering the *Trade Practices Act*, while the Australian Securities and Investments Commission (ASIC) has responsibility for administering the *Corporations Act* and the *ASIC Act*.

2.48 So, at a Commonwealth level the ACCC has prime responsibility for regulating real estate advice and promotion and gets involved if misleading or deceptive conduct is alleged. ASIC may intervene if financial products or services are involved.

Limitations of general consumer laws

2.49 As outlined above, property investment advice is currently regulated under the general consumer laws (*Trade Practices Act*), unless a financial service is included when the *Corporations Act* or the *ASIC Act* may apply.

2.50 Some of the limitations of the general consumer protection laws are:

- they only allow corrective action to be taken after misconduct has occurred;
- they do not impose adequate barriers to entry into, or participation in, the industry (such as minimum training and educational qualifications, and fitness and propriety requirements);
- they do not stipulate that investors should receive advice which is of good quality and appropriate to their circumstances, and that all risks are to be clearly presented; and

30 MCCA Discussion Paper, August 2004, p. 31. Some submissions (e.g. 14 and 20) suggested that the reason real property is excluded from FSR is constitutional - the States and Territories control matters relating to real property.

- they do not contain a positive obligation to disclose conflicts of interest.

2.51 The MCCA discussion paper explains that enforcing general consumer protection laws can be problematic:

> Unconscionable conduct-based litigation, in particular, is very resource-intensive and few cases have been undertaken. In the case of misleading conduct, and false and misleading representations, too, it can be difficult to establish misconduct, especially where the representations relate to future movements in property values or where there is any ambiguity about the falsity of claims made. These difficulties may limit the potential of the general consumer protection laws to deter rogues.[31]

2.52 The property spruikers have been able to utilise these limitations to their advantage. The MCCA discussion paper notes that the recent property boom has brought rogues and unscrupulous operators into the market, and the regulatory framework has posed few barriers to entry. It continues:

> … there is evidence that rogue traders have been attracted to property investment promotion (as well as mortgage broking) from other areas of financial services that are, or have become, more highly regulated.[32]

Evidence presented to the Committee

2.53 The submission from the Law Institute of Victoria (LIV) noted the jurisdictional limitations of the various regulatory agencies under the current regime:

> A conflict and crossover of jurisdiction exists between ASIC, ACCC and State-based consumer affairs departments. There is confusion over whether a Commonwealth or State level approach is warranted. This leads to each authority claiming it is the responsibility of the other authorities and leads to no regulatory authority taking any action and no provision of consumer assistance. Regulatory and prosecutory powers should be given to one specific authority to deal specifically with this type of behaviour.[33]

2.54 RECA commented that the ACCC was 'placed in an invidious position' in 1998 when ASIC was created and given responsibility for consumer protection in the area of financial services. To enhance the handling of complaints RECA recommends the creation of a National Consumer Protection Agency.[34]

2.55 The REIA believes that the current legislation and regulations are adequate, but have not been rigorously applied to property investment seminars.[35] When asked why Henry Kaye had managed to operate so long, the REIA replied:

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31 MCCA Discussion Paper, August 2004, p. 35.

32 MCCA Discussion Paper, August 2004, p. 44.

33 LIV, *Submission 19*, p. 4.

34 RECA, *Submission 26*, pp. 2 and 4.

35 REIA, *Submission 4*, p. 3.

> What it boiled down to, we think, is that ASIC and the ACCC needed to be more assiduous—and I think they have now got the message in that regard. Rather than just wait for complaints, they have to be more proactive and trawl the marketplace. I am delighted to see ASIC taking some web sites to task because 'Be a millionaire next Tuesday' was clearly misrepresenting …[36]

2.56 The Centre for Credit and Consumer Law at Griffith University commented:

> As the current regulatory framework does not establish barriers to entry nor provide minimum standards of advice the consumer protective mechanisms are based on deterrence. In order for deterrence to be effective it is essential that the industry participants have an interest in an ongoing presence in the marketplace. This is not the case with some participants in the property investment advice industry.[37]

2.57 The National Institute of Accountants (NIA) suggested that gaps between State laws were to blame:

> The problem with the current arrangements is not the federal laws, but the different state laws that govern this area. There are differences between the states in their legislation and in how they manage investment property advice. This lack of coordination makes it easy for unscrupulous advisors to seek the regime of least resistance. The heavy reliance of many state governments on the revenue raised from property taxes may also have caused some to be less rigorous in the application of law than might otherwise be expected.[38]

2.58 The submission from Wakelin Property Advisory suggested that lack of resources is an important issue for regulatory agencies:

> ... the ACCC does not have the resources to regularly monitor and take action against property investment advisers who mislead and deceive their clients. Take for example Henry Kaye and the National Investment Institute, who continued their operations largely uninterrupted for several years although some observers had little difficulty identifying their misleading and deceptive conduct.[39]

2.59 In responding to this comment, the Chairman of the ACCC indicated that the key issue was not resources, but that the ACCC can only act in a reactive manner. He also implied that demarcation with ASIC was a major factor at that time:

> It is fair to say that we do have the resources to deal with these matters but, ultimately, they need to be drawn to our attention … The process of

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36 Mr Stevens, *Transcript of evidence*, 28 April 2005, p. 11.

37 Griffith University, *Submission 13*, p. 2.

38 NIA, *Submission 14*, p. 1.

39 WPA, *Submission 15*, p. 5. The REIA made a similar point about resource constraints, Mr Stevens, *transcript of evidence*, 29 April 2005, p. 11.

> enforcement of the law at the commission has been undergoing some change over recent times with a view to increasing the speed and effectiveness of the way we deal with these matters … As soon as the [Robert G Allen] matter was drawn to our attention, within about three days we got to court and obtained interlocutory orders that provided for corrective material being placed at the seminar door.
>
> In respect of Henry Kaye … there was a period of time when this was a matter that we believed—and I think ASIC believed— needed to be dealt with by ASIC because it involved financial services. This is the complexity of dealing with financial services on the one hand and non-financial services on the other hand. What we got Henry Kaye on, I have to say to you, was nothing at all to do with what occurred within his seminar door. It was the advertisement for the seminar that promised to make property millionaires out of those attending his seminars. We did not focus on what occurred within the seminar door because, as you got within the door, as I have said on previous occasions, it probably fell outside the jurisdiction of the ACCC and into the jurisdiction of ASIC.[40]

2.60 In recent times the ACCC and ASIC have cooperated more closely in areas of overlapping jurisdiction, through the exchange of information, the referral of matters to the agency best placed to take it on, and the cross-delegation of powers. That cooperation was formalised with the signing of a Memorandum of Understanding (MOU) in December 2004. [41]

2.61 While the division of responsibility under the MOU has not changed substantially, the agreement clarified which aspects of property investment each agency would be responsible for and established procedures for a delegation of powers to each other. The division of responsibility is broadly as follows:

> … the ACCC continues to pursue misleading and deceptive conduct in advertising and seminar content related primarily to property, while ASIC will take action in relation to misleading and deceptive advertising and content which is related to financial services, and to the offering of financial advice from a person not licensed to do so.[42]

2.62 During the public hearing, the ACCC described the approach the two agencies would take if a new spruiker started advertising:

> Potentially, what happens is that we both start investigating. At some point, we obviously need to discuss with ASIC what we each make of it. Then perhaps—and this is where we start to lose time—we seek advice of senior

40 Transcript, 29 April 2005, pages 6 & 7.

41 The MOU was signed on 15 December 2004. ASIC, *Submission 21*, p. 2.

42 ACCC, *Submission 16*, p. 5.

> counsel, which we have done on more than one occasion, on exactly where the jurisdiction is likely to fall and on what aspects. We then would reach some arrangement with ASIC as to how the matter would be pursued.[43]

2.63 The ACCC explained to the Committee that the cross-delegation of powers with ASIC has proven more effective than attempting joint actions. But delegations can only be case-specific and take time to put in place. Furthermore, sometimes is it problematic for an agency to work with delegated powers with which it is not totally familiar. The Chairman of ACCC summed up relations with ASIC as follows:

> I would just like to emphasise that there is no lack of willingness or effort on the part of either ASIC or the ACCC to cooperate. It is working very effectively and we do that to the best of our ability. But inevitably when you are facing a prospect of going to court and having your jurisdiction challenged by the respondent to the matter, that is where I think both agencies can get themselves into some difficulty. They need to have some certainty as to their jurisdictional base.[44]

2.64 In the last eighteen months or so action by regulatory agencies has managed to rein in some of the worst excesses of property spruikers, but many consumers were burnt in the meantime.

2.65 The Committee notes that the number of property-related complaints received by agencies has fallen significantly,[45] which could be due as much to the cooling off of the property boom as to effective regulatory action. Nevertheless, many consumers became victims of spruikers during the boom, and there is clearly a need to close existing loopholes to make it difficult for spruikers to operate in the future. There is also a need to more clearly delineate the roles of the regulatory agencies. The ASIC submission admits the community is confused by the current division of responsibility. It commented:

> There has been some confusion in the media and the community more generally about the extent of ASIC's jurisdiction to regulate the activities of property investment advisers/promoters.[46]

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43 Mr Cassidy, *Transcript of evidence*, 29 April 2005, p. 11.

44 Mr Samuel, *Transcript of evidence*, 29 April 2005, p. 12.

45 ACCC, *Submission 16*, p. 17. In 2003 the ACCC was receiving 8 to 10 property-related complaints and enquiries per day. By early 2005 the average had dropped to 2 per day.

46 ASIC, *Submission 21*, p. 1.

Possible regulatory approaches

2.66 The Committee considers that the current regulatory regime in relation to property investment advice (primarily based on general consumer laws) is not able to provide an adequate level of protection for consumers, and should be strengthened.

2.67 Despite firmer action by the ACCC and ASIC in recent times, the reality is that spruikers, both for property investment and other get-rich-quick schemes, are still able to operate. The MCCA discussion paper notes that seminars are still being promoted and conducted, and there is evidence that marketing operations are continuing by other means as well. Mr J Allen of The Investors Club advised the Committee:

> When I look at Saturday's Courier Mail, for instance, there are still clearly unlicensed spruikers advertising every Saturday. They are still out there. The state legislation here has gone a long way in reducing their activity and some named players mentioned before have either fallen foul or have had their activities curtailed. It has not completely wiped it out in our view but it is certainly at much smaller levels than it was.[47]

2.68 RECA estimates that 80 spruikers have been active in the last 12 months. RECA advocates the creation of a dedicated National Consumer Protection Agency whose staff would comprise experienced fraud investigators as well as highly qualified forensic accounting specialists, law enforcement officers and consumer protection analysts.[48]

2.69 The ACA told the Committee:

> … the attention on Henry Kaye has maybe had a bit of a dampening effect but the reality is people are still flocking to wealth creation seminars and these sorts of seminars and they are still paying up to $9,000—sometimes even more—to go on three-day seminars. I think in many instances they are doing it partly driven out of a desire to make a lot of money—that is a pretty understandable thing for people to want to do—but it is also that many people do not know where else to go. They have been told they have to provide for their future financial security by investing and they do not know enough about it to be discerning.[49]

2.70 The submission from Griffith University urged the Commonwealth to take action:

> As consumers are extremely vulnerable to fraudulent, negligent or inappropriate provision of advice and there is a significant risk of the loss

47 Mr Allen, *Transcript of evidence*, 13 April 2005, p. 40.

48 RECA, *Submission 26*, p. 2.

49 Ms Wolthuizen, *Transcript of evidence*, 15 April 2005, p. 43.

> of large amounts of money or even the loss of the major asset of the family home, we strongly support government intervention in relation to the property investment industry by the inclusion of the provision of property investment advice in the financial services regulatory framework.[50]

2.71 The LIV recommends a coordinated regulatory regime to address the deficiencies in regulation, as evidenced by the numerous property investor schemes that continue to flourish with little consumer recourse available.[51] In regard to this situation the LIV recommended:

> … an authority (whether an existing authority or a new authority) should be given specific powers and authority to regulate the property investment advice industry and to prosecute persons involved in unconscionable behaviour. Specific direction needs to be given to avoid the existing problem of regulatory authorities declining to act because of perceived demarcation issues.[52]

2.72 The FPA commented that, although the number of scams appears to have decreased as the property boom has cooled, action needs to be taken now to ensure they cannot occur again in the next boom:

> With the current slowdown in the property market, many of the schemes and promotions which were of concern appear to have faded away. With the inevitable upturn in the property cycle—whenever that may be—unless the opportunity is taken now to correct the shortcomings of the regulatory regime for property investment advice, investors will once again be vulnerable to unscrupulous operators. The FPA would urge that the momentum for reform be maintained.[53]

2.73 ASIC's submission doubts that general consumer protection laws can adequately protect consumers because they cannot force disclosures nor ensure the provision of quality and appropriate advice:

> … it has been common for property promoters to present themselves as disinterested providers of investor education and other services and, as part of this, to fail to disclose interests they have in properties 'introduced' to seminar attendees, or fees and commissions received for promoting particular developments. Under the general consumer protection laws there are, we would suggest, few regulatory incentives for promoters to make these positive disclosures. [54]

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50 Griffith University, *Submission 13*, p. 2.

51 LIV, *Submission 19*, p. 3.

52 LIV, *Submission 19*, p. 8.

53 Mr Anning, *Transcript of evidence*, 15 April 2005, p. 11.

54 ASIC, *Submission 21*, p. 6.

2.74 ASIC argues that there is 'market failure' and that corrective action is needed:

> … we believe that the existing regulatory regime has not proven sufficient to deal with the worst excesses that we have seen and that it is not simply a matter of more vigorous enforcement. We believe that some changes are required.[55]

2.75 ASIC notes that spruikers can enter the property market relatively easily:

> … if the share market is booming, then marginal/spruiker/dishonest elements cannot just move into giving advice about equities. There is a whole set of requirements that they have to meet, so there are some barriers to entry that it was government policy to put in place. [*In contrast*] If the property market is booming then people with no particular training qualifications, who are just spruiking, can set up shop quite easily. There are no effective barriers to entry.[56]

2.76 The ACCC agues that, while its use of the TPA powers has been reasonably successful, a more effective regulatory approach would be to allow both the ACCC and ASIC to operate with a full range of concurrent legislative powers because:

> … the reality is that conduct may involve a combination of factors which may contravene both TPA and ASIC provisions (seminars often provide information on both property matters and financial matters such as mortgages). Hence, it is not always clear, to the regulators or even the regulated, as to who is to deal with such conduct.[57]

2.77 The ACCC contends that overlapping the jurisdictional reaches of both regulators would allow either agency to react promptly and confidently, without the need to arrange cross-delegation of powers or to face procedural uncertainty in the Courts. That would be, from the ACCC's point of view, a more effective solution than including real property under FSR.[58]

2.78 The Committee finds considerable merit in the ACCC's recommendation and feels that concurrent legislative powers would probably have enabled quicker and more decisive action against the property spruikers in the past. However, the Committee notes a MOU was signed between the ACCC and ASIC in December 2004, and the expectation by the two agencies that the MOU will enable them to react to situations much more quickly and decisively.

2.79 The Committee would like to assess the practical outcomes of the MOU over a reasonable period of time. If the outcomes are as positive as the agencies expect, then concurrent legislative powers may not be necessary.

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55 Mr Tanzer, *Transcript of evidence*, 15 April 2005, p. 23.

56 Mr Funston, *Transcript of evidence*, 15 April 2005, p. 30.

57 ACCC, *Submission 16*, p. 6.

58 ACCC, *Submission 16*, p. 6. Also, *transcript of evidence*, 29 April 2004 pp. 10 – 12.

2.80 After reviewing the available evidence, the Committee has decided that the most efficient and effective solution to ensuring the provision of good quality property investment advice is the creation of a separate asset class under FSR (see Chapter 3 for details). If this recommendation is accepted by Government, its impact should be assessed after a period of operation, to ensure that it is working as intended.

Is industry self-regulation appropriate?

2.81 Some submissions, such as from the PIAA, argued in favour of industry self-regulation.[59] But most submissions felt that company or industry self-regulation would not be appropriate to this industry. For example, the submission from the REIA commented:

> …the REIA does not support voluntary codes – while it is highly likely that REIA members would endeavour to adhere to a voluntary industry code, there is no guarantee that rogue marketers who were not members of REIA would adhere to such codes. Property investment advice cuts across various industry sectors and professional and trade groups, and a proportion of promoters are 'fly by night' operators without an industry position or reputation to maintain … While the industry association might be able to regulate compliance amongst its members, it cannot be responsible for non-members whose actions might reflect negatively upon complying members.[60]

2.82 The LIV commented that 'self-regulation is not appropriate in the case of aggressive property promoters'.[61] The Accounting Bodies commented:

> Given the nature of scams that have emerged with the likes of Henry Kaye and others, it is probably fair to say that the regulation ought to be at a government or quasi-government level on the basis that it is unlikely that any form of self-regulation will have the desired effect.[62]

2.83 The ACA felt that self-regulation would not provide sufficient protection for consumers:

> Just looking at how the sector has operated, it has markedly failed to demonstrate it could self-regulate to an adequate standard of consumer protection.[63]

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59 PIAA, *Submission 5*, pp. 21–23.

60 REIA, *Submission 4*, p. 9.

61 LIV, *Submission 19*, p. 8.

62 Mr Bobb, *Transcript of evidence*, 29 April 2005, p. 24.

63 Ms Wolthuizen, *Transcript of evidence*, 15 April 2005, p. 39.

2.84 Griffith University was definitely against self regulation:

> Self-regulation is not appropriate for this industry as there is no cohesive industry body, some firms have no interest in ongoing reputation and there are low barriers to market entry thereby permitting easy access to the market.[64]

2.85 The NIA does not believe that self-regulation is appropriate at this stage:

> The industry is one that appears to be, at least by certain sectors, focused on their own short-term interests and not the interests of the community at large. The NIA, therefore, does not believe that self-regulation would be suitable for property investment advisors, not at least in the current environment. The development of a set of national rules and regulation of property investment advisors may in the future lead to an environment where greater self-regulation may be possible, but currently the NIA believes that such a scheme would not be viable and not be in consumers' best interests.

2.86 It may be that at some future point, industry self regulation is a viable proposition. However, the Committee agrees with the view that self-regulation would be premature at this time. Accordingly, Chapter 3 proposes regulatory measures which will have the effect of supporting the industry's development and reducing competition from illegitimate property spruikers.

Commonwealth or State responsibility?

2.87 Virtually all submissions supported the view that the regulation of property investment advice needs to be nationally consistent, so that the same law applies across all jurisdictions. In that context, most submissions favoured making this a Commonwealth responsibility.

2.88 It was suggested that the fact that property spruikers normally operate across State and Territory boundaries had made it more difficult for regulatory agencies to target unscrupulous behaviour.

2.89 The LIV noted that it is common for transactions involving property to cross State boundaries, and endorsed a Federal approach to regulation.[65] The Law Council of Australia (LCA) supported 'Commonwealth legislation and the uniform administration of property investment advice laws by ASIC'.[66]

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64 Griffith University, *Submission 13*, p. 4.

65 LIV, *Submission 19*, p. 8.

66 LCA, *Submission 12*, p. 1.

2.90 The PIAA pointed out that in the property marketplace 'you can have a property developer in one State, a financier in another State, and the investor somewhere else'.[67] They called for a regulatory regime "…where the property investment advice law works across Australia with no possibility of variation in any State."[68]

2.91 Griffith University supported Commonwealth regulation 'due to the transient nature of some of the members of the industry, and the similarity of the industry to the financial services market'. Employing uniform state and territory legislation would involve the creation of a whole new framework, whereas it would be more efficient to include real property under FSR.[69]

2.92 The FPA advocated a national approach, under ASIC:

> … the FPA considers that it would be more efficient if the national regime was achieved by Commonwealth legislation rather than by a coordinated uniform approach. As financial services are governed by national legislation it would be logical that the counterpart regime for property investment advice be similarly regulated, with ASIC as the regulatory authority.[70]

2.93 The ACA argued that a regulatory regime must be nationally consistent. Their preference is for regulation by the Commonwealth, but if that is not possible, there should be uniform regulation (and enforcement processes) across all States and Territories.[71]

2.94 The NIA said that, while Commonwealth legislation would give the best outcome, it believes that current constitutional arrangements mean that there would be the constant threat of challenge. The NIA suggested that uniform State legislation would be the most practical option:

> The NIA's preference is for a model based on a framework of uniform state legislation with referral of enforcement activities to a federal authority (ASIC). The Constitutional reality is that most of the powers in relation to property investment advice reside with the state and territory governments … [would] prevent the current situation of regulatory arbitrage, where differences in state laws are used to get around the law.[72]

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67 Mr Symon, *Transcript of evidence*, 13 April 2005, p. 18.

68 PIAA, *Submission 5*, p. 23.

69 Griffith University, *Submission 13*, p. 4.

70 Mr Anning, *Transcript of evidence*, 15 April 2005, p. 11.

71 Ms Wolthuizen, *Transcript of evidence*, 15 April 2005, p. 38.

72 NIA, *Submission 14*, pp. 4 & 5.

2.95 The Commercial Law Association of Australia (CLAA) suggested that the regulation of property investment advice should be on a uniform State-by-State basis which 'would be consistent with the existing constitutional and fiscal framework'.[73]

2.96 The Committee agrees that there is a strong case for a national approach to any new regulation of property investment advice. Property investment is of interest to consumers across Australia, and they should all be able to receive similar treatment and protection wherever they reside. The Committee considers that can best be achieved through making this matter a Commonwealth responsibility.

Recommendation 1

2.97 **The Committee recommends that the regulation of property investment advice, but not of real property or real estate transactions generally, should be a Commonwealth responsibility.**

73 CLAA, *Submission 24*, p. 1.

CHAPTER 3

A new regulatory regime

What is the objective?

3.1 The Committee's objective is the creation of a regulatory regime which takes reasonable steps to protect consumers from the operations of property spruikers and other get-rich-quick promoters.

3.2 Such a regime would also provide the basis for a recognised and respected property investment advisory industry, which provides high quality and appropriate advice to consumers.

Proposed new regulatory regime

3.3 Most submissions and witnesses supported the introduction of an FSR-like regulatory regime for property investment advice.[1] For example, the submission from the Real Estate Institute of Australia (REIA) suggested that an effective solution would be to include real property within the current FSR regulations:

> The basic premise of the REIA is that all those providing investment advice should be regulated by financial services legislation, which may need to be better defined to address all asset classes, and not just financial products.[2]

3.4 A strong argument was made that investment in property is similar to investment in other asset classes and that all investors should receive the same level of protection. The submission from the Financial Planning Association of Australia (FPA) made the following comment on this point:

> When investing in real property, Australians hope to enjoy a capital return, a yield and any possible tax advantages available from the investment … In this regard, there is little difference between investing in real property to investing in what the Corporations Act 2001 considers a financial product. People making property investments should be entitled to the same protections and comforts that they would receive when purchasing a

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1 See, for example, Australian College of Financial Services, *submission 2*; Australian Property Systems, *submission 3*; Securities and Derivatives Industry Association, *submission 7*; Law Council of Australia, *submission 12*; Centre for Credit and Consumer Law, Griffith University, *submission 13*; Financial Planning Association of Australia, *submission 18*; and Ms Wolthuizen of the Australian Consumers' Association, *transcript of evidence*, 15 April 2005.

2 REIA, *Submission 4*, p. 10.

> financial product under the financial services regime contained in the Corporations Act 2001. These important and compulsory protections include membership of an external dispute resolution service, professional indemnity insurance by the adviser, having compliance structures and appropriate resources in place, and specific educational training requirements.[3]

3.5 ASIC's submission recommended regulatory comparability because 'there is a strong functional similarity between the giving of financial advice about real estate and the giving of advice about securities and other investments'.[4] The submission from the National Institute of Accountants (NIA) made the same point:

> The NIA believes that investment in real estate is no different than investment in other financial products.[5]

3.6 Griffith University made a similar observation:

> We strongly advocate for property investment advice to be included in the financial services regulatory regime ("FSR regime") as it is, from the consumer's perspective and in a practical sense, investment advice.[6]

3.7 The National Credit Union Association (NCUA) suggested that the most efficient way to regulate property investment advice is to change the definition of 'financial product' under FSR to include investment in real property.[7]

3.8 The Committee received evidence that consumers are confused by the fact that investment in different asset classes is regulated differently, with the recommendation that there should be a uniform approach to the provision of all investment advice.[8] The submission from the Australian College of Financial Services said that any new regulation should 'integrate seamlessly with FSR to give uniformity of practice, fewer loopholes, and less confusion for consumers'.[9]

3.9 Another argument presented in favour of bringing property investment advice under an FSR-like regulatory regime was that, from a practitioner's point of view, all providers of investment advice should face the same regulatory regime.[10] Is it fair that advisers on investment in financial products are subjected to much more stringent regulation than their competitors promoting investment in property?

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3 FPAA, *Submission 18*, p. 2.

4 ASIC, *Submission 21*, p. 5.

5 NIA, *Submission 14*, p. 3.

6 Griffith University, *Submission 13*. p. 3.

7 Mr Tham, *Transcript of evidence*, 13 April 2005, p. 22.

8 For example, REIA, *submission 4*, p. 3; Griffith University, *submission 13*, p. 4.

9 ACFS, *Submission 2*, p. 9.

10 For example, REIA, *submission 4*, p. 3.

3.10 On the other hand, The Investors Club opposed further regulation. It argued that consumers would be adequately protected from property spruikers if (a) they were made to provide full details of their own wealth and how it was acquired, (b) if all fees and commissions and relationships had to be disclosed, and (c) if an independent valuation of each property had to be provided.[11]

3.11 Wakelin Property Advisory also opposed further regulation, but said that consumer protection would be enhanced if property investment advisers were made to disclose all fees, commissions and relationships, so that any advice given is fully transparent.[12]

3.12 The submission from Mirvac Real Estate warned that 'over-regulation may have a significant effect on our business operation as well as increasing compliance and purchase costs for the investor'. Mirvac suggested that an effective solution would be to add a list of warnings to the front page of all contracts for sale, such as: 'be sure you can really afford this property'; 'do your own due diligence on the developer'; 'seek independent tax and financial advice'; 'property is a long term investment – do not buy for speculation'.[13]

3.13 JBA Finance Solutions thought that the desired outcomes could be achieved by the creation of an "advice license", which would be an addendum to a normal real estate agents license. It would cover those agents who wanted to provide property investment advice to clients.[14]

3.14 The Property Investment Association of Australia (PIAA) advocated a regime with 'frameworks and rules similar to the requirements of the FSRA and PS146', based on an accreditation process administered by the industry itself.[15]

3.15 The joint submission from The Institute of Chartered Accountants of Australia and CPA Australia (the 'Accounting Bodies') recommended that no decision be made until (a) there is further research on the extent of the problem,[16] and (b) the effectiveness of FSR has been reviewed. In regards to the latter point, the Committee

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11 Mr Allen, *Transcript of evidence*, 13 April 2005, pp. 29 & 42. The Law Institute of Victoria also advocates the mandatory provision of an independent valuation to purchasers, *Submission 19*, p. 9.

12 WPA, *Submission 15*, pp. 5 - 8.

13 Mirvac Real Estate, *Submission 8*, p. 1.

14 JBA Finance Solutions, *Submission 1*, pp. 5 & 6.

15 PIAA, *Submission 5*, p. 15.

16 CPA/ICAA, *Submission 23*. The submission indicates that CPA Australia is currently undertaking research into the extent of this problem, with the results expected in late June 2005.

notes that the Commonwealth is currently looking at ways to enhance the operation of FSR.[17]

3.16 The Committee considers that a full regulatory regime is appropriate to an industry of such national economic importance, which provides the accommodation needs of more than one-in-five Australians, and which often involves the life's savings of investors.

3.17 The Committee does not consider that property investment advice warrants the establishment of a whole new process—the simplest and most effective approach would be to include real property as a new asset class under the existing FSR provisions in the Corporations Act. That would immediately result in a comprehensive licensing, conduct and disclosure regime.

3.18 ASIC's submission emphasises the importance of a proper licensing system:

> … in the absence of a licensing regime of some kind, it is very difficult to stop dishonest or incompetent operators from continuing to participate in the marketplace. Even where the general consumer protection powers can be used to stop or restrict particular activities, a rogue or marginal operator is not prevented from otherwise continuing with their business or 'resurfacing' under a different name or in another legal form. Dealing effectively with such operators arguably requires the structure of a licensing regime and the power to ban individuals from holding a license and undertaking regulated activities for an extended period of time.[18]

3.19 At the public hearing ASIC reinforced this point:

> … [a licence] includes these general competency and educational type requirements that would weed out a lot of fly-by-night operators. The fly-by-night operators would not go to the trouble of getting a licence in those circumstances, together with all of the other compliance requirements that go with a properly functioning licensing regime, which is what I think we have for the financial adviser area.[19]

3.20 The NCUA also advocates a full licensing regime to persons giving property investment advice:

> The licensing regime is essentially proving to ASIC that you have controls in place, that your staff are appropriately trained under PS146 and that you have responsible officers who have the appropriate expertise to run the business and who will take responsibility and provide support for the business … We believe that the full licensing regime should apply …[20]

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17 Press release by the Parliamentary Secretary to the Treasurer, 2 May 2005, announcing a package of 25 proposed refinements to improve the operation of the FSR framework.

18 ASIC, *Submission 21*, p. 7.

19 Mr Tanzer, *Transcript of evidence*, 15 April 2005, p. 32.

20 Mr Tham, *Transcript of evidence*, 13 April 2005, p. 21.

3.21 Based on the evidence presented, the Committee considers that property investment advisers should be subject to a licensing scheme similar to that which currently applies under FSR to advisers on investment in financial products and services.

3.22 The Committee considers that making property investment advice subject to a comprehensive regulatory regime has a number of benefits, including:

- Improve the quality of property investment advice available to consumers, both general and personal;
- Substantially reduce the number of consumers who fall prey to unscrupulous operators;
- Ensure that consumers receiving investment advice on any asset class have the same regulatory protection;
- Establish adequate entry and participation barriers for fly-by-night and incompetent operators;
- Encourage the professionalisation of the provision of good quality and appropriate advice by competent advisors;
- Close the regulatory gaps which enable property spruikers and marginal operators to function.

3.23 The Committee recognises that regulating property investment advice under FSR will introduce compliance costs for individuals and businesses providing property investment advisory services. There will also be costs to Government in administering and enforcing the legislation. However, the Committee considers that the expected benefits of such regulation, as outlined above, will far outweigh the additional costs involved.

3.24 Most submissions, including that from the Real Estate Institute of Australia (REIA), argued that any new regulatory regime should be designed to protect retail investors in real property. The REIA said :

> Any new regulatory regime should be limited to retail investors, given that this is the consumer group which has experienced harm and/or loss. All forms of real property, including residential, commercial, retail and industrial property, should be covered.[21]

3.25 The Committee agrees with this view. Recommendation 4, at para 3.56 below, outlines the coverage of the proposed regulatory scheme.

21 REIA, *Submission 4*, p. 8.

Definition of property investment advice

3.26 For the purpose of the proposed new regulatory regime, the Committee believes that "property investment advice" should be defined as including:

- advice in relation to the prospect of an investment return (capital growth or income) from a particular property, and over a defined timeframe;
- advice in relation to the prospect of an investment return from one among a portfolio of properties; and
- advice which suggests a strategy of investing in property on the basis of a proposed investment return (capital growth or income).

3.27 The key principles which underpin this definition are:

- The essence of property investment advice is that it relates to the *future*. Statements about the current value, rental yield or characteristics of a property, and statements about the past characteristics of a property, although relevant in evaluating the historical investment performance of a property, are not property investment advice; and
- Property investment advice involves making claims about investment returns—it is not necessary, for instance, that a specific return be forecast. General statements that property investment will reap a return are sufficient; and
- The presence or absence of advice about other asset classes is irrelevant (if advice about other asset classes is occurring, the adviser would be required to have an FSR licence anyway).

Features of the new regulatory regime

3.28 The Committee recommends that the foundations of the proposed regulatory regime should be:

- Any person giving property advice must hold an Australian Financial Services license under the proposed new "property investment advice" regulatory regime.
- The license must be held personally by the person giving the advice.
- A number of exemptions (carve-outs) should apply, including:
  - Accountants giving advice on taxation matters and subject to the CPA and ICAA disciplinary processes;
  - Lawyers giving advice on legal matters and subject to the disciplinary processes for solicitors;
  - Valuers, giving advice on current property valuations;

- Real estate agents who stick to providing present and past information (because this is not "property investment advice");
- Lecturers delivering a university course, or teachers delivering a course in a school environment;
- Educators delivering a course approved by Australian National Training Authority (ANTA, now part of the Department of Employment and Workplace Relations);
- Fair comment in the mass media.

3.29 The Committee considers that a comprehensive regulatory regime for property investment advice would include provisions for the following:

- A licensing regime (which requires minimum standards of conduct and minimum standards of the quality and appropriateness of advice; and includes specified training and educational qualifications);
- Disclosure obligations regarding conflicts of interest, relationships, fees, commissions, contents of educational courses, and charges;
- Cooling off periods;
- The requirement to advise clients of both upside and downside risks;
- An undertaking to act honestly, fairly and efficiently;
- Anti-hawking provisions;
- An internal dispute resolution process in place; and
- A recognised course of study delivered by a reputable institution.

Who should be regulated?

3.30 The MCCA discussion paper recommended that a functional rather than an occupational approach would be most appropriate.[22] This view was supported by most submissions, including from the NCUA:

> Approach to this area must be targeted to the activity rather than any specific occupation … We believe that a functional based approach to regulation, similar to the FSR provisions, would be most appropriate and effective, rather than an occupation based approach.[23]

3.31 The Committee agrees that a functional approach should be taken so that all those who engage in property investment advisory activities (including advice about financing arrangements), whatever the setting or form of the advice and whoever the provider of the advice may be, are covered.

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22 MCCA Discussion Paper, August 2004, p. 37.

23 NCUA, *Submission 9*, pp. 4 & 5.

3.32 However, the Committee considers that, consistent with the current approach to regulating other financial advice, certain activities should be excluded ('carved-out') from coverage of the new regulation. For example, accountants giving tax advice and lawyers giving legal advice in relation to property investment. These two professions have well-established codes of conduct which are rigorously enforced. The Accounting Bodies told the Committee that FSR currently provides a carve-out for accountants on the basis that they are strictly regulated:

> They have compulsory professional indemnity insurance … every five years they are required to submit to a quality control review. Any trust accounts … must be audited by an independent auditor … the accounting bodies have their own disciplinary proceedings in which they can effectively discipline an act of misconduct.[24]

3.33 The Committee received considerable evidence on the question whether or not real estate agents should be excluded from any new regulatory regime which covers property investment advice.

3.34 Some submissions argued that as real estate agents are already subject to State and Territory legislation they should be exempted from any new regulation. For example, the submission from the REIA recommended:

> Real estate practice is already highly regulated by the State and Territory governments, therefore any change to regulations should not unduly affect the 'high street' real estate agent…[25]

3.35 On the other hand, other submissions made a strong case for including real estate agents on the basis that, in everyday life, they provide the bulk of property investment advice to consumers. For example, the submission from The Investors Club noted that 99 per cent of property investment advice comes from real estate agents, who represent only one side of the transaction – the vendors.[26]

3.36 The NCUA noted that comments by real estate agents and mortgage brokers can mislead prospective buyers and that any regulation of property investment advice should cover such professionals. It said:

> Comments [by real estate agents and mortgage brokers] on the growth and rental potential of property may often be misleading and overstated to induce potential buyers.[27]

3.37 The PIAA recommended that, because training courses for real estate agents normally do not cover investment issues, 'no carve-out be available to real estate agents where they seek to provide overall property investment advice."[28]

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24 Mr Bobb, *Transcript of evidence*, 29 April 2005, p. 24.

25 REIA, *Submission 4*, p. 1.

26 The Investors Club, *Submission 10*, pp. 1 & 3.

27 NCUA, *Submission 9*, p. 3.

3.38 The Securities and Derivatives Industry Association (SDIA) suggested that the point of difference could be if a real estate agent is dealing with a purchaser who will be an owner-occupier or a purchaser who is buying the property for investment.[29]

3.39 On 14 February 2000 ASIC reported to Government on its review of the financial advising activities of real estate agents. ASIC found that:

> Many real estate agents give, and see it as part of their function to give, general financial advice to potential buyers of investment property. Typically, this advice takes the form of advice about the likely capital appreciation or rental incomes from the property - basically, its investment return potential. Sometimes this advice will include some general taxation advice, such as about the benefits of negative gearing.[30]

3.40 On the basis of their research ASIC concluded that general financial advice provided by real estate agents as an incidental part of selling real estate should include warnings that (a) the advice is only general advice, and (b) that purchasers should assess the suitability of any property investments in the light of their individual circumstances. The real estate agent giving general advice should also make full disclosure of any conflicts of interest, relationships and fees and commissions.

3.41 Furthermore, ASIC recommended that where individual advice is provided, the real estate agent should be subject to 'similar regulatory requirements as investment advisers who give personal securities recommendations'.[31]

3.42 ASIC's recommendations were referred by the Commonwealth to the States and Territories. They eventually led to the MCCA working party being formed, and the discussion paper on property investment advice issued by MCCA in August 2004.

3.43 Only NSW and the ACT made minor changes to legislation as a result of ASIC's February 2000 report on real estate agents:

> … it is fair to say that those proposals have not been picked up except in a couple of small instances … the New South Wales and ACT real estate legislation now have some requirement about disclosing conflicts of interest but, generally speaking, the licensing of real estate agents continues not to go to the issue of advice at all.[32]

3.44 After careful consideration, the Committee reached the conclusion that there should not be a general 'carve-out' for real estate agents, as they are such a vital part of

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28 PIAA, *Submission 5*, p. 20.

29 Mr Clark, *Transcript of evidence*, 15 April 2005, pp. 3 & 5.

30 *'ASIC Completes Review of Real Estate Agents'*, ASIC Media Release, 14 February 2000, page 2 of Summary.

31 *'ASIC Completes Review of Real Estate Agents'*, ASIC Media Release, 14 February 2000, pages 1 & 2. See also ASIC, *Submission 21*, p. 4.

32 Mr Tanzer, *Transcript of evidence*, 15 April 2005, p. 27.

the property industry. Rather, there can be a specific carve-out for real estate agents doing their normal work of selling and managing property. However, real estate agents will need to be very conscious that when they go beyond the provision of factual information to prospective property investors, it becomes advice.

3.45 For example, if real estate agents provide historical information on a property (e.g. current outgoings, recent rent levels achieved, past capital appreciation) — the Committee considers that to be factual information. But, if they provide comments on possible future costs or future rents or future capital appreciation or the use of deposit bonds or negative gearing, that becomes advice.

3.46 This distinction is especially important in view of the growth of 'off-the-plan' sales in recent years.[33] Any commentary regarding possible rents or values in 2 or 3 years time is obviously speculative and should be seen as property investment advice. The submission from the Australian College of Financial Services makes the point that investors buying off-the-plan often do not appreciate the downside risks.[34]

3.47 While real estate agents would need to be more careful in their comments to prospective investors, the Committee agrees with ASIC's view that they would quickly adjust to the new requirements.[35] Those real estate agents who wanted to deal in investment property would take the necessary steps to obtain an Australian Financial Services Licence to enable them to provide property investment advice.

3.48 ASIC suggests that it would improve the general competence and standing of the average real estate agent if a segment on how investment markets work is included in their training courses.[36]

3.49 The Committee notes that a functional approach, as recommended, would capture the activities of an important sector of the property industry which, till now, appears to have escaped even minimal regulation. These are the sales agents (either direct employees or contractors) used by developers to sell their own property developments.

3.50 Such sales agents have been able to operate without a real estate licence or certificate. Thus they have not been subjected to the codes of conduct or educational requirements which apply to normal real estate agents. The Accounting Bodies identified unlicensed 'marketing consultants' selling property for developers as an important issue:

> … [marketing consultants] are somehow outside the scope of the regulated scheme, where states are involved in ensuring that registered real estate

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33 For example, The Investors Club commented that in recent times off-the-plan sales had increased to about 50% of total sales. Mr Allen, *Transcript of evidence*, 13 April 2005, p. 33.

34 ACFS, *Submission 2*, p. 3.

35 Mr Tanzer, *Transcript of evidence*, 15 April 2005, p. 32.

36 Mr Tanzer, *Transcript of evidence*, 15 April 2005, pp. 32 - 33.

> agents toe the line, maintain trust accounts and are licensed and that their sales staff have the appropriate certification … the question is: are they registered and are they licensed and does the property developer who engages these persons take an active role—undertake due diligence—in ensuring that these 'marketing consultants' are properly registered and licensed with the relevant state bodies to ensure that the developers are doing the right thing?[37]

3.51 The submission from the REIA advocates that anyone selling and/or managing real property should operate under a real estate agents license. One of the recommendations made by the REIA is that:

> Property developers selling their own properties must be licensed [real estate agents]. All employees of developers who are engaged in real estate transactions should be registered to conduct those transactions.[38]

3.52 Spruikers have been able to utilise this loop-hole to sell properties on behalf of developers (or themselves if they own the properties), often at inflated prices (so called 'two-tier or multi-tier marketing'). They often offer a package to a client which includes the provision of expensive or inappropriate financing to pay for the investment property.

3.53 The Committee considers that this is a major deficiency in the current system. It agrees with the REIA that sales staff of developers should operate, as a minimum, under a real estate agent's license. If those sales staff also provide property investment advice, as defined in this report, then they should operate under an AFS license as well.

Recommendation 2

3.54 **The Committee recommends that Chapter 7 of the Corporations Act 2001 be amended to include real property as a separate asset class.**

Recommendation 3

3.55 **The Committee recommends that a definition of property investment advice should be inserted into the Corporations Act 2001. This definition should make it clear that property investment advice encompasses representations about the future value of, or income from, a property. It does not include statements about the past or present income from the property.**

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37 Mr Bobb, Transcript of evidence, 29 April 2005, p. 23.

38 REIA, *Submission 4*, p. 6.

Recommendation 4

3.56 **The Committee recommends that anyone providing property investment advice should have an Australian Financial Services Licence unless:**

- **They give advice during a university course or similar approved training course; or**
- **They are an accountant, solicitor or valuer giving information in the course of their professional activities; or**
- **They are making fair comment in the mass media, where the comment is not made in the course of soliciting customers for any good or service.**

Enforcement

3.57 If the Committee's recommendation for a new regulatory regime to cover property investment advice under FSR is accepted, ASIC will have prime responsibility for its enforcement.

3.58 However, the Trade Practices Act (TPA) will still be an important regulatory tool, particularly in relation to other get-rich-quick wealth creation promoters.

3.59 The ACCC alerted the Committee to their view that, notwithstanding much closer cooperation between them and ASIC, a more effective regulatory approach would be to allow both the ACCC and ASIC to operate with a full range of concurrent powers. That would enable quick and decisive action to be taken against unscrupulous promoters.

3.60 The Committee notes that the ACCC and ASIC signed a Memorandum of Understanding (MOU) in December 2004 to facilitate consultation and procedures in situations where it is not clear which agency should take responsibility for a particular activity which requires investigation.

3.61 As the MOU was only signed a few months ago the Committee would prefer to see how it operates in practice before commenting on the need for concurrent legislative powers for the ACCC and ASIC. Furthermore, the Committee would like to first evaluate the Government's reactions to this report and also the outcomes of the review of property investment advice being undertaken by the Ministerial Council on Consumer Affairs.

3.62 The NIA recommended that even if the decision is made to regulate property investment advice through the introduction of uniform State and Territory legislation, the actual powers to enforce that legislation should be ceded to ASIC:

> The NIA does not believe that the state governments have shown sufficient resolve in relation to protecting the interest of consumers and their reliance on property taxes creates a conflict of interest. As such, the enforcement and prosecution of breaches of the new regime should be ceded to ASIC, as the regulator of other forms of investment advice.[39]

3.63 However, as the Committee is recommending that property investment should come under the Corporations Act, which is Commonwealth legislation, ASIC would automatically be responsible for its enforcement.

Remedies

3.64 The submission from the Law Institute of Victoria (LIV) recommended the establishment of a more accessible system of obtaining remedies.

3.65 The LIV noted that the current procedures to claim civil remedies pursuant to the *Trade Practices Act 1974* and State fair trading Acts are expensive, complex and time-consuming which are all negatives to purchasers seeking redress.

3.66 The LIV suggested that tribunals (such as the Victorian Civil and Administrative Tribunal) should be used instead of courts and that procedures could be changed to give a purchaser more scope for remedy. For example, it recommended changing the onus of proof where it is established that the purchaser was introduced to the property by a spruiker who did not make the proper disclosures; and recommended changing the rules of evidence to allow investors to rely upon representations made by a spruiker, notwithstanding that they do not form part of a written contract.[40]

3.67 The ACCC's submission also recommended a number of changes to improve the remedies available to victims of spruikers who are successfully prosecuted, as discussed below.[41]

Remedies for all victims

3.68 At present the TPA restricts remedies to consumers who give prior written consent to a claim. The ACCC believes that this is too restrictive, and that restitution should be available for all victims where a contravention of the TPA is proven.

3.69 The Committee notes that there is some precedent for this, in s.80B(b) of the TPA, which allows the court to order refunds to named consumers in the event of a breach of section 75AU (price exploitation in relation to the new tax system). The

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39 NIA, *Submission 14*, p. 4.

40 LIV, *Submission 19*, pp. 8 & 9.

41 See also the discussion on remedies in the public hearing, *transcript of evidence*, 29 April 2005, pp. 9 – 11.

Committee considers that, for property spruiking offences under the TPA, the courts should be able to make a similar order, compelling the spruiker to issue refunds to consumers either identified individually or as a class.

Recommendation 5

3.70 **The Committee recommends that, where property spruikers contravene the Trade Practices Act, the courts should be able to make an order compelling the spruiker to issue refunds to consumers either identified individually or as a class.**

3.71 Such an order would be limited to refunds, not to damages in the event that damage is suffered. However, a successful action by the ACCC on behalf of some consumers does give rise to the potential for other victims to take action in accordance with section 83 of the TPA, which allows findings of fact in the original case to be regarded as *prima facie* evidence in any subsequent case. Use of this section allows subsequent litigants to take advantage of the previous proceedings, thus improving the likelihood of them obtaining suitable damages.

Civil pecuniary penalties

3.72 The ACCC also calls for civil pecuniary penalties for breaches of the provisions of Part V of the TPA (other than section 52). Currently to obtain fines or monetary penalties under the TPA for Part V offences, the ACCC must pursue a criminal prosecution which is considerably more resource-intensive (and costly) than civil litigation. The submission explained it this way:

> In many consumer protection matters, including property investment matters, it is important to take swift action in order to stop ongoing conduct and minimise damage to consumers. A slower, more complex criminal investigation is not appropriate in those circumstances … In short, the current framework results in a situation where penalties are not sought in cases which warrant such measures, because the procedure involved is too unwieldy to produce a successful outcome for consumers …
>
> For this reason, the ACCC believes that it is necessary to introduce a civil pecuniary penalty regime in relation to consumer protection matters (other than section 52) to more effectively deter activity by property investment advisers and others likely to breach the Act.[42]

3.73 Civil pecuniary penalties are currently available under section 76 of the TPA for breaches of a restricted range of provisions under the TPA (Part IV, s.75AU, s.75AYA). However, where the court imposes both a penalty, and compensation to victims, the compensation must be paid first (s.79B).

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42 ACCC, *Submission 16*, p. 24

3.74 Extending the provisions of s.76 to cover all of Part V (other than s.52) would be a dramatic step with far-reaching consequences for consumer affairs in Australia. While there is no doubt an argument for this extension to occur, such a recommendation would be well outside the terms of reference for this inquiry, and would probably require an inquiry in its own right (along with extensive negotiation with State and Territory governments). The Committee simply has not undertaken the work required to make such a recommendation.

3.75 However, for Part V offences relating to property spruiking, the Committee would support the extension of civil pecuniary penalties, to be imposed subject to s.79B.

Disgorgement

3.76 The ACCC argues in favour of statutory recognition of disgorgement as a complementary remedy that a court may order to deprive those who contravene the TPA or their ill-gotten goods or benefits.[43] The Committee is sympathetic to this view. However, the Committee considers that if the court has the power to order refunds to victims, and has the power to impose civil pecuniary penalties, then a disgorgement remedy is unnecessary.

3.77 Disgorgement, which may operate in a similar manner to an account-of-profits in contract law, would be a complex remedy to implement. It may, for instance, involve forensic accounting in order to determine what were the actual proceeds of the breach.

3.78 The Committee is not prepared to support disgorgement at this stage.

Cease and desist powers

3.79 During its consideration of the powers required by the ACCC in order to deal appropriately with property spruiking, the Committee turned its attention to a possible tool which was not raised in evidence. In particular, the Committee was concerned to provide the ACCC with an enforcement tool which could be used before spruiking seminars take place, to prevent potential victims from sustaining losses. In other inquiries, more focussed on the TPA, the ACCC has called for "cease and desist" powers, which would enable the ACCC to issue enforceable orders preventing conduct which it considers contrary to the TPA:

> Cease and desist orders provide interim administrative orders restraining corporations from engaging in specified anti-competitive conduct. A decision to issue an order would be based on the Commission's reasonable satisfaction of prima facie anticompetitive use of market power, if urgent

43 ACCC, *Submission 16*, pages 7 & 21-23.

> action was required in the public interest. Judicially imposed penalties and injunctions would be available for breach of a cease and desist order.[44]

3.80 The Dawson Review of the Competition Provisions of the Trade Practices Act, and the subsequent Senate Economics References Committee report on the effectiveness of the *Trade Practices Act 1974* in protecting small business both recommended against granting the ACCC cease and desist powers, because there were already appropriate means for the ACCC to act to prevent anticompetitive conduct.

3.81 The same arguments do not apply in the case of property spruikers. In this case the harm prevented is not activity in a relatively well-formed and functioning market, but sporadic preying by spruikers with little forewarning other than the spruikers' advertising. The Committee has not tested evidence on this question and is therefore not in a position to make a strong recommendation in relation to cease and desist powers. However any review of the ACCC's powers which follows this report should seriously consider the use of a tightly restricted cease and desist power which the ACCC can use to prevent spruikers from conducting their business in cases where speed is required.

Recommendation 6

3.82 **The Committee recommends that the Treasurer should examine the utility of providing the ACCC with cease and desist powers to prevent spruiking activity which, if conducted, would contravene any provision of the *Trade Practices Act 1974*.**

Professional education & training

3.83 The fledgling PIAA advised the Committee that Deakin University, through its commercial education division DeakinPrime, will introduce a new Diploma in Property Investment in the second half of 2005. Following discussions with the Financial Services Education Advisory Authority, the PIAA is confident that this Diploma will meet standards equivalent to those in ASIC's Policy Statement 146 on Training of Financial Product Advisers.

3.84 The PIAA hopes that this diploma will become the recognised educational qualification for property investment advisers in Australia.[45] Mr J Hopkins, Inaugural President of the PIAA told the Committee:

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44 ACCC, *Submission 56 to the Review of the Competition Provisions of the Trade Practices Act* (the "Dawson Review"), p. 95.

45 PIAA, *Submission 5*, p. 10.

> A hugely important part of the career and the training of any property investment adviser must be learning about property in a far deeper way than they might be taught at the moment … They must be able to kick the bricks, they must be able to know value, they must be able to assess supply and demand and they must be able to have a philosophy about what the future will be for that particular category of property.[46]

3.85 The Investors Club also advised the Committee that it had developed the concept of a basic educational qualification for property investment advisers through an appropriate TAFE course.[47]

3.86 The Committee is strongly in favour of the initiatives to introduce an appropriate educational qualification for property investment advisers. This will help to give credibility to the participants, and such a qualification would represent an important step towards making property investment advice a recognised profession. The diploma course developed jointly by the PIAA and Deakin University is a laudable scheme and seems well-designed and timely.

3.87 The Committee also considers that it will be important for an appropriate program of continuing professional development to be introduced to underpin this evolving profession.

The issue of 'educational seminars'

3.88 The Committee received evidence that the so-called 'educational seminar' approach is used not only by property spruikers but also by other get-rich-quick promoters, such as for share market software programs and horse racing betting systems.

3.89 The spruikers and promoters use the seminar or workshop approach in an endeavour to avoid the regulators – they claim that they are only providing educational and/or training courses, and not advice.

3.90 The FPA described it this way:

> There are gaps in the regime and there are grey areas … people who can move outside the regime by saying, 'We're not providing advice; we're providing education,' or 'We're providing factual information.' That is not regulated.[48]

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46 Mr Hopkins, *Transcript of evidence*, 13 April 2005, p. 6.

47 The Investors Club, *Submission 10*, p. 1.

48 Mr Graham, *Transcript of evidence*, 15 April 2005, p. 21.

3.91 ASIC told the Committee:

> … as the property market has cooled a little and other markets have come along, we have seen similar types of activity in relation to share-trading software, in relation to some other types of exotic products and also in relation to the bare educational seminar—some of which I would describe as not much more than broad motivational seminars that offer nothing by way of practical investment advice and are much more about motivating people to believe that if they have a good idea they can do something with it and make money out of it themselves … there are always get-rich-quick schemes and educational seminars out there that are promoting heavily and really pushing the psychological buttons that go to people wanting to increase their wealth.[49]

3.92 ASIC continued:

> If Henry Kaye had had to have a financial services licence or something equivalent then it would have been easier to take proactive action … if you are limited to the general consumer protection laws then you have to wait for someone to do something in breach of the conduct requirements before you can do anything.
>
> … as it currently stands, if a person is running an educational seminar purely advocating direct investment in property then there is nothing that prevents that person from doing that other than the general law which goes to misleading and deceptive conduct or unconscionable conduct. The difficulty there is that that tends to be a reactive remedy—that you would need to see the misleading representations made before you could take action.
>
> In the absence of something that says the person who is engaging in this type of activity needs some form of licence or authorisation to do it, you will always be left with that reactive remedy of having to go along and see whether the person is making misleading or deceptive comments. At least in relation to property—which is a significant investment class—we think that there are reasonable grounds for saying that the situation is unsatisfactory and that there should be improvement … I can tell you that, as an enforcement agency, if you have the capacity to go to court and to say, 'This looks like an investment seminar; the person is not licensed; it has to stop,' then you very quickly get an injunction and it stops the seminar from proceeding …[50]

3.93 The Committee wants a practical solution to be found which provides consumers with adequate protection not just from bogus educational or training seminars but also from other marketing strategies used to promote similar get-rich-quick messages. The issue is illustrated in the following exchange which took place during the public hearing with the Australian Consumers Association (ACA):

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49 Mr Tanzer, *Transcript of evidence*, 15 April 2005, p. 24.

50 Messrs Funston and Tanzer, *Transcript of evidence*, 15 April 2005, p. 29.

> **Senator MURRAY**—I would like to add to this. I am concerned that we are getting over-obsessed with seminars. It seems to me that modern marketing enables very targeted one-to-one marketing to occur, and I can see that if the seminar area is clamped down on they will simply switch, as they did with mass marketed investments. Mass marketed investments—on the tax effective side—mostly were not sold through mass meetings or seminars; they were sold on a direct basis, assisted by word of mouth. I think that this will go in the same direction. My view is that regulation is required even if the seminar area is tightened up and closed down. I have been concerned that the good activities of ASIC, ACCC, you and others in drawing attention to seminars do not address the fundamental issue, which is that people are persuading investors that they will get returns which are unrealistic from high-risk investments.
>
> **Ms Wolthuizen**—I think it comes down to how you frame the legislation or regulation in this area. The way FSR operates now, it does not really matter whether you are operating on a one-to-one basis or speaking to a group if you stray into giving personal financial advice without being licensed and without meeting all the requirements that come with that. Perhaps that is a good way of approaching the concern you have that, whether it is by a seminar, a one-on-one meeting or a small group scenario, if you are selling people property as an investment that purports to meet their personal financial needs then you will be captured. [51]

3.94 The Committee would like to see this loop-hole closed. The suggested definition of property investment advice should make it very difficult for spruikers to run any seminars based on real property if they do not have an AFS licence in place. The only carve-out would be in relation to "Educators delivering a course approved by ANTA (now DEWR)".

3.95 However, that also raises the wider issue of financial literacy, and the need for some sort of advisory service for ordinary Australians. The ACA commented:

> When we look at issues around financial literacy, maybe it is time that we also consider what we are now seeing as an advice gap for Australian consumers. For many people access to financial advice is beyond their means, but they do have the need to access it and maybe it is time to consider some of the kinds of initiatives that have been entered into overseas: looking at the provision of free advice through, say, the Citizens Advice Bureau in the UK, which is currently under pilot.[52]

3.96 The LIV recommends a consumer education campaign coupled with a central bureau providing information and advice to potential investors.[53]

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51 Ms Wolthuizen, *Transcript of evidence*, 15 April 2005, p. 46.

52 Ms Wolthuizen, *Transcript of evidence*, 15 April 2005, p. 39.

53 LIV, *Submission 19*, p. 3.

3.97 The Committee does not want to restrict the use of seminars or workshops as a legitimate marketing and communication tool. That would be unfair to honest property investment advisers and may indeed constrain the development of the legitimate property investment advice industry.

3.98 Furthermore, if the use of seminars is specifically restricted by regulation, property spruikers could just move on to use other means of contacting consumers (e.g. internet, direct mail, telemarketing, etc).

3.99 A better solution would be to make it difficult for spruikers to commence operating in the first place, and to continue operating, by giving regulatory agencies the ability to act quickly and proactively. The Committee considers that including real property under FSR will mean that spruikers promoting property will need an AFS license and be subject to all the related codes of conduct and probity. While no absolute guarantee against unscrupulous behaviour, it will be much more difficult for spruikers to operate.

CHAPTER 4

Buyer beware - a plea from the Committee

4.1 In this report, the Committee has endeavoured to set out a regulatory scheme which will give property investors the same protection given to investors in other asset classes. By imposing a licensing regime, and the regulation of commercial behaviour and practice by licensees, the Committee hopes both to develop the legitimate property investment advice industry, and to force property spruikers out of the market.

4.2 There are, however, inevitable limits to what can be achieved by a regulatory scheme. In 2004, the Senate Economics Committee aptly quoted the Appeals Court of Massachusetts, which stated:

> What is unfair is a definitional problem of long standing, which statutory draftsmen have prudently avoided. It is impossible to frame definitions which embrace all unfair practices. There is no limit to human inventiveness in this field.[1]

4.3 No regulatory scheme, without being tyrannical in nature, can completely shut down the use of deceit and manipulation in commercial practice. While the proposed regulations will make operation more difficult for spruikers, it is inevitable that they will remain and do their best to skirt this, or any other, regulatory scheme.

4.4 Once the regulatory scheme is in place, it will remain necessary for consumers to be alert, to look to their own interests, and to approach anything which looks "too good to be true" with a healthy scepticism.

4.5 In this context the Committee notes the pertinent suggestion by the Real Estate Institute of Australia that the recommendations of the 2004 Consumer and Financial Literacy Taskforce be enhanced to include 'a stronger focus on property investment (which receives less coverage than investment in other asset classes)'.[2]

4.6 The Committee recommends that the Government take heed of this suggestion when implementing the Taskforce's recommendations.

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1 *Levings v Forbes & Wallace Inc* 8 Mass.App.Ct 498, 396 N.E.2d 149, quoted in Senate Economics References Committee (2004) *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business*, p.35.

2 REIA, *Submission 4*, p. 9.

Recommendation 7

4.7 **The Committee recommends that in implementing the recommendations of the 2004 Consumer and Financial Literacy Taskforce, the Government includes a stronger focus on property investment.**

Recommendation 8

4.8 **The Committee recommends that the Government continue and expand its programs to enhance financial literacy among consumers and to increase financial advice available to consumers.**

4.9 The Committee makes the following specific appeals to Australians considering property investment.

Seminars are marketing exercises

4.10 Legitimate property investment seminars are usually held by legitimate property dealers trying to encourage investors to invest in property, and in particular to do so through them. The seminars are a marketing exercise. Of course, marketing is legitimate – our economy is awash with well-regulated marketing strategies enticing consumers to buy all manner of things. But seldom are consumers asked to pay to receive advertising. We do not pay an admission price to watch television advertisements. We do not pay to receive junk mail. The product sellers pay for their marketing. Why should marketing property investment be any different?

4.11 Be wary if the seminar presenter encourages you to enrol in further training or educational courses. These can be expensive. Investigate the course content carefully and the credentials of the people delivering the course content. Even with advertised 'money-back-guarantees', many consumers have experienced difficulty in obtaining refunds.

Check the internet

4.12 In many cases, people who have been stung by spruikers tell their stories online. The Australian Consumers Association (www.choice.com.au) regularly provides warnings about spruikers. Your States or Territory's Department of Consumer Affairs or Fair Trading may do the same. Profit from the experiences of others.

Choose your own lawyer and accountant

4.13 You should immediately be suspicious if a property promoter offers to arrange a lawyer to give you legal advice and do the conveyancing for you, or an accountant to give you tax advice. If the lawyer or accountant is receiving multiple – maybe dozens – of referrals from this developer, then whose interests will they have at heart? Will they provide you with good advice, or will they act in a way which ensures the continuing flow of referrals?

4.14 If you choose your own lawyer and accountant, hire them and pay them yourself, you know which side they are on.

Get your own valuation

4.15 Don't believe what the promoter tells you about the real price – and don't believe the bottom line number on a valuation provided to them. If you choose and hire a valuer yourself, and they answer only to you, then you have the security of knowing whether you are paying a fair price. "Two-tier marketing schemes" are only able to exist because people believe inflated information about the value of a piece of property.

4.16 At the very least get a copy of the valuation done by the bank or lending institution, and immediately ask questions if that valuation is appreciably different from the purchase price. But if the promoter is also arranging finance through his own sources, be sceptical of the valuation provided by that linked institution. It is always better to get a valuation from an independent valuer. There may be a cost involved, but at least you will have a much better idea of the real value of the property.

4.17 The Committee received evidence that the disclosure of valuations by lending institutions to prospective borrowers would be of significant benefit to consumers. Such disclosure would alert borrowers if the price they were paying was significantly in excess of the valuation. It would make 'two-tier marketing' by property spruikers much more difficult. Apparently banks and credit unions provide their valuations to borrowers if they insist, but it is not a commonplace practice.

4.18 The Committee agrees with this evidence, and recommends that the disclosure of valuations by lending institutions to prospective borrowers should be made mandatory.

Recommendation 9

4.19 **The Committee recommends that the disclosure of valuations by lending institutions to prospective borrowers be made mandatory.**

Get your own finance

4.20 Beware of linked finance arrangements. Beware of any finance arranged by anybody other than yourself or your own financial advisers. If you cannot independently go out and arrange finance from a finance provider completely external to the property investment scheme, then this is a very strong signal that you should think carefully whether this investment is right for you.

4.21 Property investment by its nature usually involves large amounts of money. Be wary of taking on high debt levels. Realise that property is usually a long term investment and allow for the fact that interest rates and other economic factors may go against you, at least for a term of the projected investment.

Don’t be rushed

4.22 During its inquiries, the Committee formed the view that one of the simplest ways to tell a property spruiker from a legitimate property investment adviser is to observe whether they are trying to rush the consumer into making a deal. A legitimate property adviser will have no difficulty in allowing a consumer time to reflect and consider their options. A legitimate property adviser will have no difficulty in allowing a consumer time to arrange their own valuation, finance and lawyer. Even if a deal falls through while these processes are underway, it is better to miss out on a deal than to rush into an ill-considered investment decision. Missing out on a deal will not lead to financial ruin – but an ill-considered investment may well do so.

4.23 If your "adviser" is trying to rush you into making a deal, you should think about why. Are they trying to stop you from getting an independent valuation? Are they trying to stop you from getting independent financial advice? Are they trying to rip you off? The answer, unfortunately, is likely to be yes.

Demand advice about downside risk

4.24 Every investment without fail carries downside risk. Markets can both rise and fall. A legitimate property investment adviser will be able to describe to you the risks associated with an investment. A spruiker will focus on the potential gains, and will be dismissive of risk. There are always downside risks. If your adviser won't tell you about them, it is legitimate to ask what they don't want you to know.

Understand that your home is at risk

4.25 A substantial number of investors secure their investment loan with equity in their home.

4.26 In principle, there is nothing wrong with a consumer borrowing against the equity in their home. But if you do so, you must understand that if the loan goes into default, your home is at risk. If something goes wrong, and you have secured the loan against your home, then you could lose your home.

4.27 Home equity is important. The considerations are even wider than the significant physical and physiological elements involved in people living in their own homes. Home equity is very often the core of a family's wealth and more than the titleholder have a legitimate interest, such as spouse or partner and offspring.

4.28 The Committee feels that, given the social and economic importance of home equity, a suitable cooling-off period, say 14 days, should apply to any loans for investment in property which are underwritten by equity in the borrower's home.

Recommendation 10

4.29 **The Committee recommends that any loans for investment in property which are secured by home equity should be subject to a waivable 14 day cooling off period.**

Summary

4.30 The Parliament could not, without being draconian, implement regulations to cover every possible source of unfair spruiking conduct. Consumers must not simply rely on regulators. Instead, a partnership between consumers, regulators and industry bodies is required. The scheme proposed by this Committee is likely to make operation more difficult for spruikers, but no amount of regulation can remove the need for the buyer to beware.

Recommendation 11

4.31 **The Committee recommends that ASIC conduct targeted advertising and educational campaigns to alert consumers to the risks associated with property investment in general, and with get-rich-quick spruikers in particular.**

Senator Grant Chapman

Chairman

APPENDIX 1

SUBMISSIONS RECEIVED BY COMMITTEE

1. JBA Finance Solutions Pty Ltd
2. Australian College of Financial Services
3. Australian Property Systems
4. Real Estate Institute of Australia
5. Property Investment Association of Australia Pty Ltd
6. Property Planning Australia
7. Securities & Derivatives Industry Association
8. Mirvac Real Estate Pty Ltd
9. National Credit Union Association Inc
10. The Investors Club
11. The Law Society of South Australia
12. Law Council of Australia
13. Griffith University
14. National Institute of Accountants
15. Wakelin Property Advisory
16. Australian Competition & Consumer Commission
17. Mr William Roddick
18. Financial Planning Association of Australia Limited

19 Law Institute of Victoria

20 PIR Independent Research Group

21. Australian Securities & Investments Commission
22. Credit Union Services Corporation

23. The Institute of Chartered Accountants in Australia

24. The Commercial Law Association Limited

25. Mr Vincent Mangioni

26. Real Estate Consumer Association (Inc)

APPENDIX 2

PUBLIC HEARINGS AND WITNESSES

WEDNESDAY 13 APRIL 2005 – SURFERS PARADISE

ALLEN, Mr John Henry, General Manager and Licensee, The Investors Club Ltd
HIGGINS, Mr Neil Trevor, Business Development Manager, The Investors Club Ltd
HOPKINS, Mr John Stephen, Founding Chairman, Property Investment Association of Australia
SYMON, Mr Bruce Richard Sydney, General Manager, Property Investment Association of Australia
THAM, Mr Joe Yew, Legal Manager, National Credit Union Association Inc.

FRIDAY 15 APRIL 2005 – SYDNEY

ANNING, Mr John Melville, Manager Policy and Government Relations, Financial Planning Association of Australia
CLARK, Mr Doug, Policy Executive, Securities and Derivatives Industry Asssociation
FUNSTON, Mr Michael David, Senior Policy and Education Officer, Consumer Protection, Australian Securities and Investments Commission
GRAHAM, Mr Sean, Member, Financial Planning Association Regulations Committee, Financial Planning Association of Australia
ORSKI, Mr Gil, Analyst Policy and Government Relations, Financial Planning Association of Australia
ROAN, Mr Peter, Financial Planner, Chair, Western Division Chapter, Financial Planning Association of Australia
TANZER, Mr Greg, Executive Director, Consumer Protection and Regional Commissioner, Queensland, Australian Securities and Investments Commission
WOLTHUIZEN, Ms Catherine Nicole, Senior Policy Officer, Financial Services, Australian Consumers' Association

THURSDAY 28 APRIL 2005 – CANBERRA

COPPARD, Mr Jason, Proprietor, Willerby’s Solicitors; and Member, Law Institute of Victoria
STEVENS, Mr Bryan, Chief Executive Officer, Real Estate Institute of Australia

VERHOEVEN, Ms Alison, Public Affairs Manager, Real Estate Institute of Australia

FRIDAY 29 APRIL 2005 – CANBERRA

ANTICH, Mr Robert, General Manager, Policy and Liaison Branch, Australian Competition and Consumer Commission

BAILEY, Mr Brendan, Government Liaison Section, Australian Competition and Consumer Commission

BOBB, Mr Richard, Chair, Legislation Review Board, Australian Accounting Research Foundation

CASSIDY, Mr Brian, Chief Executive Officer, Australian Competition and Consumer Commission

SAMUEL, Mr Graeme Julian, Chairman, Australian Competition and Consumer Commission