

Australian Property Systems Limited
Submission
to
Senate Inquiry

Current Investment Property Advice in Australia:

In the current method of property sales, investment property has mostly been sold through Real Estate Agents or Property Marketing Groups who typically tell their client that their major investment should be in property and as a result their client ends up with an over weighting of property and are hurt badly when a downturn occurs in the sector. Real Estate Agents and Property Marketing Groups know very little about other investment products like shares etc and have never been licensed to give investment advice as their licensing regime does not cater for it, even though they are basically giving investment advice on a regular basis.

Also Dealer Groups (currently called FSR Licensees), have never been able to give advice on Investment property (a property where the investor controls the title to the physical property e.g. not a trust or syndicate) because it has not been a product allowed on the recommended list nor has it been an asset class included in a balanced portfolio nor is property considered a product under FSRA. Also most dealer groups and their Authorised Representatives (hereinafter referred to as "AR") know very little about property and therefore have not recommended it to their clients.

The problem with this is that most of their clients don't receive good advice or a balanced portfolio that includes investment property and end up with a large weighting in shares even though physical direct property is the largest asset class on earth and as a result of the over weighting in shares they are badly affected when the sector has a downturn.

This misdemeanor happens because Property Agents are regulated under State Legislation and the Dealer Groups and their AR's are regulated under the Financial Services Reform Act which Is Federal Legislation.

A real problem that also exists in the current environment is that Real Estate Agents or Property Marketing Groups will not send their clients to Dealer Groups or their AR's because the AR talks the client out of property and into shares and other forms of investment and vis a vis Dealer Groups and their AR's will not send their client to a Real Estate Agent or a Property Marketing Group because they talk their client out of Shares etc and into property therefore the client is given bad advice from both groups and does not end up with a balanced portfolio.

Another major problem with the selling of investment property through Real Estate Agents and Property Marketing Groups is most of the agents get paid by the vendor or the developer (product manufacturer) therefore they are the vendor or the developers representative and cannot act for the client, but they still give advice and recommend the property to the client even though they have a two very real conflicts of interest,

- 1 they cannot represent the client because they are being paid by the vendor or product manufacturer
- 2 they do not know their clients full financial circumstances and are not advising their client on a balanced portfolio because it does not include shares and other forms of investment product

This same problem exists within Dealer Groups in that there is both an ethical dilemma and a major conflict of interest that is unavoidable because many AR's within the industry are paid commissions by the product manufacturers instead of receiving a fee for services. This creates a major dilemma because who are they acting for ? the product manufacturer or the client, but they still give advice and recommend the product to the client even though they have a two very real conflicts of interest,

1. they cannot represent the client because they are being paid by the vendor or product manufacturer
2. they do not know their clients full financial circumstances and are not advising their client on a balanced portfolio because it does not include property.

Another problem that exists in the selling of investment property is that if an owner occupier purchases a property, they are not given investment advice by a licensed advisor even though the property purchase may represent the largest investment they may make in their life, and also most of the time they are unable to afford the repayments on a loan needed to purchase the property but they have still had the property recommended to them even though it did not suit their financial circumstances.

A further problem that exists with the current method of selling investment property is that an investor requires a high rental return to service any debt attached to the loan on the property. A real problem because of the mismatch in legislation is that the investor cannot be given any advice on the structuring of the loan by the Real Estate Agent on how they might better structure their investment so not to be so reliant rent because the Real Estate Agent is not Licensed to give that advice and just for the record nor are Mortgage Brokers who continue to give investment advice in the true sense of the word to both investors and owner occupiers.

It is obvious when you look at this ludicrous situation, all groups are not meeting ethical standards of conduct, have enormous conflicts of interest, are not acting in the best interest of the investor or owner occupier and on top of all of the above, I believe all groups are breaching the Financial Services Reform Act (hereinafter referred to as "FSRA") because they do not know the full extent of their clients financial circumstances.

The Federal and State regulators cannot continue to turn a blind eye to this problem and need to have Real Estate Agents and Property Marketing Groups comply with the Financial Services Reform Act.

This is not a hard problem to solve and does not require the writing of any new Legislation but requires small amendments to FSRA to include property as a product and require Real Estate Agents and Property Marketing Groups to have FSRA Licensed personnel in their employ . Also changes are required to State Real Estate legislation to the effect that every Real Estate Agent or Property Marketing Group must have an Authorised Representative of a Dealer Group as a full time employee in their office to give investment advice to the client on all transactions. Also an amendment would need to be made that required any Property Sales person (who have good Real Estate Product knowledge) be licensed under FSRA to simply give Product advice.

The licensing under FSRA of the Property Sales person for particular product advice can be quite easily achieved in a 2 module course of 1 week which basically trains them in the FSRA compliance environment. This course is already available at a number of recognized training colleges situated in Queensland who currently conduct these courses.

This new course should be a compulsory supplement to any Real Estate Course required by the salesman for training in Real Estate knowledge.

This is much the same as happened to the Motor Vehicle Dealers when the Uniform Credit Code was introduced. This act basically forced Motor Vehicle Dealers to employ the services of a qualified Finance Business Manager who was attached to the Lender and gave advice only on the finance to the client after the salesman had sold the vehicle to the client e.g. the Finance Business Manager was giving client advice and the Salesman was only giving product advice. This has worked very well with Motor Vehicle Dealers and has in fact enhanced their business.

Each State could implement this process very quickly providing FSRA is amended to include property as a recognised product under the act and that investment advice on property can only be given by FSRA licensed personell.

A proposed Solution to the Problem

According to one but not necessarily the only aspect, the solution to the problem resides in the delivery of a FSR compliant Licensing structure that allows the Real Estate Agents, Property Marketing Groups and maybe even Mortgage Brokers to be PS 146 compliant as General Authorised Representatives (Product Advisor) (hereinafter referred to as “GAR”), who only represent the vendor or product manufacturer and attaching them directly to a PS 146 compliant AR (Client Advisor) hereinafter referred to as (AR) who only represent the client within their existing business environment.

Preferably each Real Estate Agent, Property Marketing Group and Mortgage Broker employ the services of a AR within their business environment (licensed cell) who is attached to an existing FSR Licensee.

Preferably the FSR Licensee licenses the Property Sales Person and also Mortgage Brokers as GAR to give product advice only. They operate together within a licensed cell and report directly to the FSR licensee (for compliance reasons) on investment advice matters and report directly to the business owner on business matters in accordance with figure 1

Preferably there are five GAR and one AR who work in a licensed cell which allows the GAR to sell the investment property on behalf of the vendor or product

manufacturer and receive a declared commission and then if the client buying the product requires the giving of client advice then the GAR is not able to give the client advice but must let the AR deal with the client so as to give the client advice on how the product being purchased, suits that clients individual circumstances, the AR receives a fee for service for this advice.

Preferably under each FSR Licensee there is a Company that is responsible for managing compliance of all of the AR's and separate Company that is responsible for managing compliance of all of the GAR. The same thing can be achieved by One FSR licensee who is responsible for managing compliance of AR and a separate FSR Licensee who is responsible for managing compliance of GAR. This sort of structure is already being implemented in the marketplace by ourselves and others who wish to be compliant regardless of legislation.

Preferably both these companies or separate licensees operate under the same compliance regime to enforce that the GAR is unable to give client advice but can only give product advice. e.g. the GAR can tell the client how good the product is but they are unable to tell the client if the investment suits their individual circumstances. The GAR therefore is compelled under the act to pass the client to the AR to see if the product being sold suits the clients individual circumstances.

Preferably both the AR and GAR can for the first time recommend physical direct property as part of a balanced portfolio under one FSR licensing regime.

Preferably the GAR does a 4 - 6 day training course with a recognised training organisation before being PS 146 compliant to give product advice only and prior to being licenced by the FSR Licensee.

Preferably the GAR and AR will give product and client advice respectively to owner occupiers as well as investors to ensure the product being sold meets the clients individual circumstances.

If this process was adopted there would be no need to change the industry bodies who already self regulate under FSRA and State Real Estate legislative environments..

What is the preferred option?

The bringing together of Financial Advisors and Property Marketing Groups into one licensed cell, where investment advice can be given on property in a FSRA compliant environment to the advantage of all stakeholders. e.g. The client gets good product knowledge and advice whether the product suits their individual circumstances and also is recommended property as part of a balanced portfolio, the Financial advisory industry become intimately associated with direct property and the Property Marketing Groups become intimately associated with other financial products.

Also this option has the capacity to force the situation whereby product advice is only given by a GAR who knows the product well and also client advice is only given by an AR who knows the clients individual circumstances.

Also this option has the capacity to substantially reduce conflict of interest situations that are prevalent in all current methods of giving investment advice.

Should it be Commonwealth or State?

Combined

Other information

In order that this submission can be more readily understood and put into practical effect, reference will now be made to the accompanying illustration wherein:

The attached Figure 1 shows a preferred architecture for how the FSR Licensee Structure selling physical direct property will be managed and how individual cells operate within the compliant structure.

Figure 1 comprises a flow diagram of a preferred architecture that identifies the Compliant FSR Licence regime under the FSR Licence (1) for the joining of GAR and AR in a single cell environment.

Preferably the property product is investment grade rated (2) as to the suitability of the clients individual circumstances in relation to the investment by an independent research organisation. This is currently being done on certain physical direct property and therefore can be achieved.

A general advice Company or Licensee (3) will manage all of the compliance for product advice within the GAR structure with the GAR reporting to this Company or licensee within the FSR Licence environment.

A full advice Company or licensee (4) will manage all of the compliance for client advice within the AR structure with all of the AR reporting to this Company within the FSR Licence

Both the AR and GAR will be FSR compliant so they can form an individual cell that allows the Property Sales Person to become a GAR with the services of AR operating within that cell.

This will allow the GAR to sell product and give product advice and then hand the client over to the trusted AR to give the client advice. This allows the GAR to go out and sell the next product while he knows that his client is being given the best advice to suit his individual circumstances and therefore fencing the client into the business environment.

The Real Estate Agent is protected in this environment as any investment advice that is given is done in a FSR compliant regime.

Mortgage Brokers can also form an individual cell that can also be attached to the Real Estate Agent that allows their loan advisors to become a GAR with the services of AR operating within that cell.

This will allow the GAR to sell mortgage product and give only mortgage product advice and then hand the client over to the trusted AR to give the client advice.

This allows the GAR to go out and sell the next mortgage product while he knows that his client is being given the best advice to suit his individual circumstances and therefore fencing the client into that business environment.

The Mortgage Broker is protected in this environment as any investment advice that is given is done in a FSR compliant regime.

This same process can apply to Accountants (8) so they can form an individual cell that allows their accountants to become a GAR with the services of AR operating within that cell.

This will allow the GAR to sell product and give product advice (can receive a declared commission payable by the vendor) then hand the client over to the trusted AR to give the client advice (fee for service).

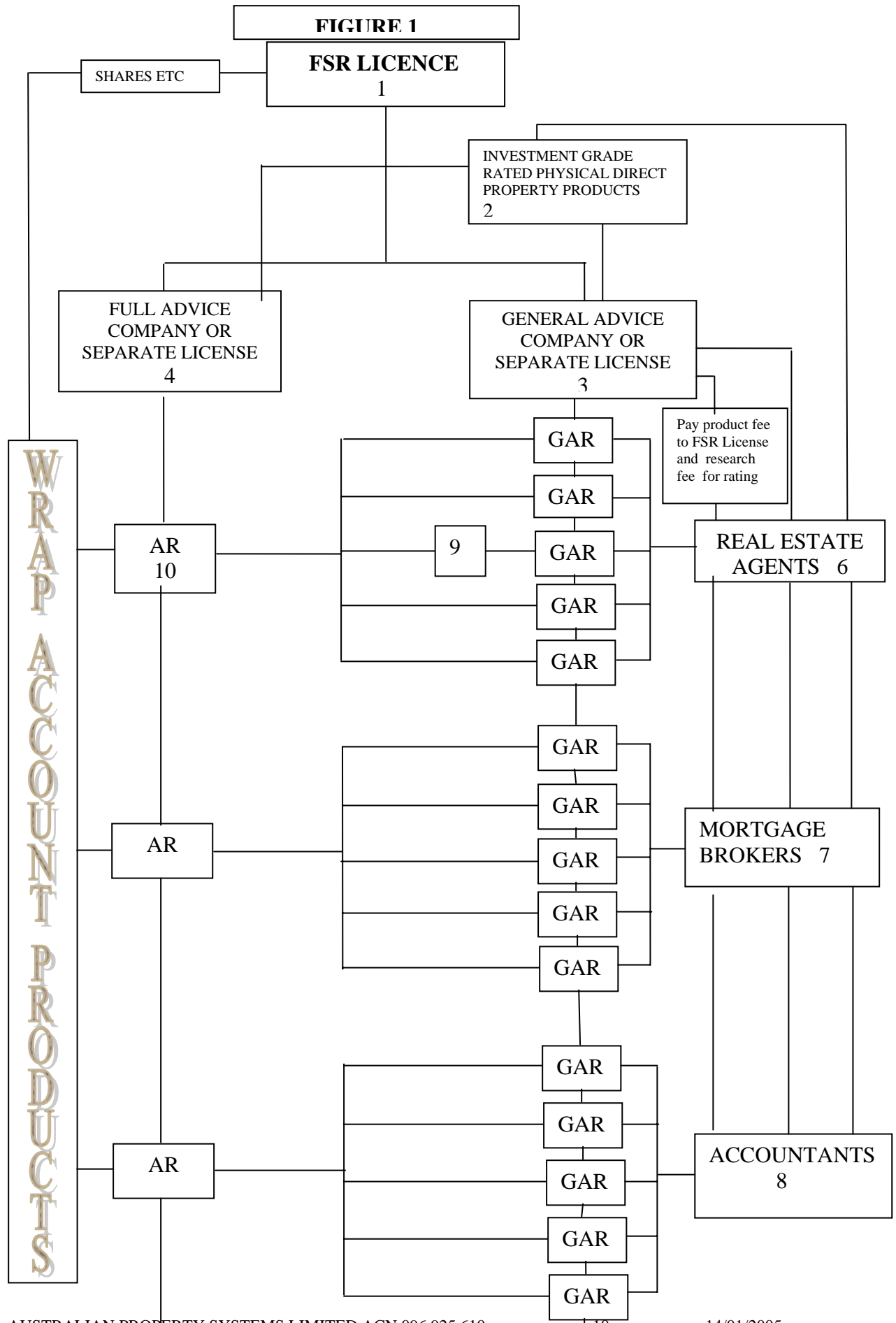
This allows the GAR to go out and sell the next product while he knows that his client is being given the best advice to suit his individual circumstances and therefore fencing the client into the business environment.

The Accountant is protected in this environment as any investment advice that is given is done in a FSR compliant regime.

All of the above environments are basically one stop shops that can deliver a good balance of both physical direct property and also other products from within the Wrap to suit the clients individual investment needs. Also by bringing Mortgage Brokers into the regime loans can be tailored to suit the product mix that best suits the clients individual circumstances within a balanced portfolio of investments.

Within each cell the GAR (9) will give the product advice and sell the product to the client and then the client will be introduced to the AR (10) who will ensure that the product suits the clients individual circumstances. The AR is the only one that has direct access to the Wrap Account or Master Trust to manage the client affairs.

For further information on this submission contact Geoff Jamieson Managing Director Australian Property Systems 0732217890 or mobile 0417778862



C:\sub CLIENT ADVICE ONLY FULLY PS 146 COMPLIANT

gs\Temporau PRODUCT ADVICE ONLY TRAINED BY Approved Training Organisations