SUBMISSION BY
NATIONAL CREDIT UNION ASSOCIATION INC

SENATE INQUIRY
INTO REGULATION OF PROPERTY INVESTMENT ADVICE

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INTRODUCTION

The National Credit Union Association Inc (NCUA) is responsible for representing the interests of member credit unions to the appropriate governmental departments, authorities and parliamentarians, as well as advising members of all appropriate legislative and related developments and requirements.

Credit unions are financial co-operatives, owned and controlled by their members. Credit unions operate by predominantly borrowing from, and exclusively lending to their members. Credit unions lend to their members for a variety of purposes including to acquire commercial or residential investment properties.

In the last couple of years there has been a marked increase in the level of lending to members for acquiring residential investment properties. In this context, it is crucial for regulators to respond, to ensure that advice on investing in property is:

- of a minimum standard of quality and documented;
- appropriate and feasible for the consumer; and
- not impacted by conflicts of interests, including disclosure of fees, commissions and interests.

RETAIL INVESTORS AND THE PROPERTY MARKET

From a credit union perspective, growth in property investment can be seen in various statistics compiled by APRA. Schedule 1 shows the financial position of all credit unions on a cumulative basis from December 2002 to December 2003. In particular it shows a growth in housing loans in that period from $14.6bn to $17.3bn (18.5% growth over the period).

It is also relevant to note some of the statistics in the quarterly APRA insights publication. Schedule 2 is an extract from the latest APRA insight publication detailing the breakdown of credit unions' assets. It is relevant to note that approximately 72% of credit unions' total loans and advances are attributable to housing loans.

Although there are no details of the split between investment and owner occupied in these statistics, we anticipate an increasing proportion of retail investment loans in recent times. We also anticipate that the growth of housing loans would generally be reflected across the ADI sector.

From a lender's perspective it is generally difficult to assess whether a borrower appreciates the down side risk associated with property investment, and accordingly we cannot provide any insights to the Parliamentary Joint Committee on Corporations and Financial Services (PC) on this issue.

THE PROBLEMS OF CONCERN

We believe that key areas of concern 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, arrangements and relationships which promoters have with property developments;

- 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.

These problems are significant particularly when the value of investment property is taken into account. These problems are likely to have a significant material impact on consumers and need to be addressed by government.

These problems identified are not exclusive to property investment promoters, but also arise from the activities of real estate agents and mortgage brokers. Comments on the growth and rental potential of property may often be misleading and overstated to induce potential buyers. Mortgage brokers may also provide advice on structuring of finances to acquire investment property, which may cause concern. The PC should focus on these issues, as a regulatory response to the concerns from property investment advice should be sufficiently wide in scope to cover these situations as well.

Given the current level of regulation in the financial services sector by the *Corporations Act*, it is almost incomprehensible that there are deficiencies existing in dealing with the activities of property investment promoters. We would contend that the lack of regulation of the sector, or perhaps even the failure of ASIC to explore fully the extent of their powers and jurisdiction under the *Corporations Act*, has contributed to the fluid nature of the sector.

CURRENT LEGAL FRAMEWORK AND REGULATORY ACTION

We note that there are various pieces of legislation potentially regulating the activities of property investment promoters, however none have the potential to fully regulate these activities other than the financial services provisions in the *Corporations Act 2001* (the FSR provisions) and the consumer protection provisions relating to financial services in the *Australian Securities and Investments Commission Act 2001.*

We note that ASIC has proffered the view that the FSR provisions do not apply to property investment advice and property related promotional and wealth creation training activities because of the way "making a financial investment" is defined in the FSR provisions.

We believe that a closer examination of the FSR provisions is warranted. Certainly some of the activities and method of operation of property investment promoters appear wider than merely selling real estate to consumers. It is relevant to note that as with most other provisions of the *Corporations Act,* legal regulation over activities is primarily determined by whether activities and entities fall within various defined terms and phrases. Within the FSR provisions, the definition of "financial product" is important and a threshold consideration. We do not propose to set out in detail the definition of "financial product" except to say that it has a wide meaning, which includes a "facility" through which a financial risk is managed.

It is relevant to explore the meaning of "manages a financial risk". Section 763C of the *Corporations Act* provides that a person "manages financial risk if they:

1. manage the financial consequences to them of particular circumstances happening or;
2. avoid or limit the financial consequence of fluctuations in, or in the value of, receipts or costs (including prices and interest rates).

We contend that some of the activities of property investment promoters, may fall within the definition of financial product. In considering this, one should remember that a financial product need not be a tangible item itself, such as real estate, but may also be the training course or strategies being marketed. It appears that property investment promoters invariably tie "free" information seminars to a particular investment scheme involving not only a "real estate" product, but also a strategy promising maximum returns with minimal financial consequences or risk.

In our view seminar content which covers things like:

- how to use deposit bonds (and managing the consequences of a deposit being payable when the investor does not have available funds to pay it);
- how to re-sell properties bought off the plan before settlement (and therefore managing the consequences of being required to complete a purchase when unable to do so); and
- how to avoid risk of loss through a borrower's default by investing in mezzanine mortgage lending,

will be a facility through which a person manages financial risk. In our view, these activities are likely to fall within the reach of the FSR provisions.

As the definitions of "financial product" and "financial service" in the *Corporations Act* are adopted in the *ASIC Act* all of the prohibitions and remedies contained in that Act, such as misleading and deceptive conduct or unconscionable conduct, will be available to consumers.

We recommend that the PC consider the scope and jurisdictional reach of both the *Corporations Act* and the *ASIC Act* further, as applicability of the FSR provisions is likely to go to the heart of some of the concerns with property investment promoters.

In relation to the current regulatory regime dealing with real estate agents, we note that each State has their own regime dealing with matters such as licensing, disclosure of benefits, obtaining beneficial interest in property, and trust accounting. To a certain degree the disparity on these issues do not cause us concern. However we note that there is also disparity in the scope of provisions relating to making of false and misleading representations. Although the provisions largely complement general consumer protection laws, we believe that a more targeted approach consistent with any regulation on property investment advice is warranted. Our views apply equally in the case of mortgage brokers or any other property marketeer (not necessarily holding a real estate licence). Approach to this area must be targeted to the activity rather than any specific occupation.

From credit unions' experience, and more generally the financial services industry, the FSR provision has created an environment of exhaustive regulation of the conduct and products of participants. We do not propose to expand on our views regarding over-regulation of this sector, but we believe that it is nonsensical to have for instance basic deposit products like a bank account (which we would contend are very well understood financial product) and their issuer be subject to a plethora of regulation while property investment promoters and the various risk minimisation schemes which they market continue to escape regulation.

In many instances the asset values of real estate properties are quite significant compared to some financial product, with the potential to cause financial ruin for consumers. Certainly government or the regulator in such circumstances should explore fully the applicability of the FSR provisions to property investment advice.

We do not propose to go though the FSR provisions except to say that it will certainly have the capacity to regulate property investment advice, or could be readily amended to do so.

THE SCOPE OR COVERAGE OF REGULATION

We contend that a model similar to the FSR provisions will be the most appropriate for property investment advice. 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.

We believe that the activities covered should include advice about the financing of property investment, as they are integral to the whole property investment transaction. The PC will need to be careful here as it would be undesirable to further regulate the activities of credit unions in providing finance. Currently the consumer credit code deals with the situation of provisions of finance. So general advice about finance products, which are offered by credit unions, should be distinguished from advice on financing arrangement or scheme linked to the property investment advice.

We believe that any new regulation should cover retail investors investing in any interest in property (including residential and commercial). The definition of "retail" under the FSR provisions will need to be adjusted to ensure the full applicability to property investment advice.

Any carve out to be given to the real estate industry should be limited. Any advice above the virtues of a particular property, which the agent is marketing, has the risk of potentially misleading purchasers. Advice in this context, whether general or personal, should be regulated to the full extent. This view also applies equally to other providers of property investment advice, including mortgage brokers and property marketeers not licensed as real estate agents.

Again we believe that the FSR provisions provide a solid foundation for any new regulation to be modelled on. Given that the most desirable model is similar to that of the FSR provisions, we believe it is appropriate to examine at length whether the FSR provisions do in fact apply to investment property advice. As noted above, we believe that the definitions in the FSR provisions are sufficiently wide to cover property investment advice, or could be readily amended to do so.

REFORM OPTIONS AND THEIR IMPACT

Our view is that a comprehensive licensing, conduct and disclosure regime should apply to property investment advice. We believe that this option is the most appropriate for a number of reasons as follows:

1. The impact on consumers from misleading or incorrect property investment advice can be significant. It could lead to bankruptcy or significant financial hardship.

2. A full licensing regime will deter "fly by night operators" and significantly improve the reputation and relationship that property investment promoters have with the consumer.

3. The cost to operators may be significant but given the relative value of properties and the significant risk of loss to consumers in some of the schemes (eg mezzanine finance), we believe it is justified.

4. Currently credit unions are regulated under the FSR provisions. There is a lack of parity in regulation for financial product advice given by credit unions and investment property promoters. This has the potential to mislead consumers who may assume parity in regulation.

A STATES AND TERRITORIES' OR A COMMONWEALTH RESPONSIBILITY

Regulation by the commonwealth is the most desirable course to take, with a commonwealth agency (ASIC) being responsible for administering the regulation.

We suggest that the PC examine the applicability of the FSR provisions to property investment advice. Although the nature of financial products is different in character to real estate per se, the provision of property investment advice in itself does appear to come within the definition of "financial product". A review of the applicability of existing FSR provisions to the sector should be undertaken before progressing to implement new regulations covering property investment promoters.

SCHEDULE 1

Financial Position for All Credit Unions
($ million)

	Dec 2002	Mar 2003	Jun 2003	Sep 2003	Dec 2003
ASSETS					
Cash and liquid assets					
Notes and Coins	266.3	211.1	191.8	220.7	256.3
Deposits at Call	1,054.8	983.6	968.0	1,040.0	1,005.6
Gold Bullion	0.0	0.0	0.0	0.0	0.0
Due from Clearing Houses	4.3	1.1	1.9	1.4	0.7
Securities purchased under agreements to resell	0.0	0.0	0.0	0.0	0.0
Due from Financial Institutions	1,007.4	884.5	890.8	807.7	799.9
Total Trading Securities	8.2	2.3	1.2	9.9	10.2
Total Investment Securities	1,085.4	1,032.1	1,082.2	1,137.9	1,120.4
Total Other Deposits	1,561.1	1,740.6	1,836.4	2,269.2	2,302.6
Net Acceptances of Customers	0.0	0.0	0.0	0.0	0.0
Loans & advances					
Housing Loans	14,638.6	15,206.8	15,873.2	16,287.4	17,278.0
Other Loans & Advances	7,020.4	7,047.4	6,999.7	6,897.8	6,740.3
Total Loans and Advances	**21,658.9**	**22,254.2**	**22,872.9**	**23,185.2**	**24,018.4**
Total Net Loans and Advances (net of provisions for impairment)	**21,513.6**	**22,101.7**	**22,720.2**	**23,032.8**	**23,865.6**
Total Other Investments	173.9	177.4	179.5	180.0	165.2
Net Fixed Assets	409.9	408.4	403.7	402.5	397.9
Net Intangible Assets	4.5	4.5	11.1	11.9	11.7
Total Other Assets	305.2	253.8	241.6	279.7	335.1
Total Assets	**27,402.9**	**27,801.1**	**28,554.4**	**29,393.8**	**30,283.1**
LIABILITIES					
Due to Clearing Houses	0.5	1.2	0.6	0.0	0.0
Total Due to Financial Institutions	89.9	103.6	83.1	85.5	95.1
Acceptances	0.0	0.0	0.0	0.0	0.0
Deposits					
Call/on Demand	12,007.6	12,107.7	12,665.3	13,329.1	13,708.1
Term Deposits	11,375.5	11,622.2	11,764.1	11,856.1	11,961.9
Certificates of deposit	0.0	0.0	0.0	1.8	0.0
Other	76.4	86.8	101.8	46.4	69.8
Total Deposits	**23,459.4**	**23,816.6**	**24,531.1**	**25,484.5**	**25,965.2**

Financial Position for All Credit Unions
($ million)

	Dec 2002	Mar 2003	Jun 2003	Sep 2003	Dec 2003
Total Other Borrowings	487.9	474.1	527.6	366.3	635.3
Total Income Tax Liability	31.2	33.1	36.6	38.0	28.4
Total Provisions	87.3	84.8	87.6	91.9	92.1
Total Bonds, Notes and Long Term Borrowings	512.0	496.9	463.3	415.8	496.5
Total Creditors and Other Liabilities	324.8	336.7	321.0	357.0	362.3
Total Loan Capital and Hybrid Securities	20.6	23.4	28.5	29.6	31.7
Total Liabilities	**25,017.0**	**25,370.8**	**26,079.8**	**26,869.4**	**27,707.1**
Net assets	**2,385.8**	**2,430.3**	**2,474.6**	**2,524.4**	**2,576.0**
SHAREHOLDERS' EQUITY					
Total Shareholder's Equity	**2,385.7**	**2,430.2**	**2,474.6**	**2,524.3**	**2,576.0**
Number of Institutions	193	189	187	183	180

SCHEDULE 2

Credit Unions and Building Societies

Table B1 Credit Unions and Building Societies: Assets

December 2003	Credit Unions Small	Medium	Large	All	Building Societies
	As a percentage of total assets				
Cash and liquid assets					
Notes and coins	1.4	1.1	0.8	0.8	0.6
Deposits at call	10.7	6.1	2.9	3.3	1.3
Other liquid assets	3.3	2.0	2.7	2.6	0.8
Total cash and liquid assets	15.3	9.3	6.4	6.8	2.7
Government securities	na	0.5	na	0.1	1.4
Other securities	0.4	1.8	3.9	3.6	15.3
Other deposits	15.2	13.6	7.0	7.6	1.2
Loans and advances					
Housing loans	38.1	44.6	58.6	57.2	65.4
Other loans and advances	26.7	27.3	21.0	21.6	11.7
Other investments	0.7	0.6	0.5	0.5	0.7
Fixed assets	1.7	1.5	1.3	1.3	1.0
Intangible assets	0.0	0.0	0.0	0.0	0.1
Other	0.9	1.0	1.1	1.1	0.5
Total assets ($ billion)	0.5	2.5	27.3	30.3	14.1
Number of institutions	**51**	**57**	**72**	**180**	**14**

Notes

Details on table may not add up to totals due to rounding of figures.

Credit union and building society figures from December 2001 onwards are based on the new reporting requirements.

Figure B1.1

Growth rates have been adjusted for breaks in series.

Figure B1.2

The first break in the series for building societies is due to a change in classification of housing loans for investment purposes from housing lending to commercial lending.

The second break in the series is due to a new reporting requirement change requiring housing loans for investment purposes to be reclassified from commercial lending to housing loans for investment.

Figure B1.1 **Credit Unions and Building Societies** / Year-ended asset growth

Figure B1.2 **Credit Unions and Building Societies** / Total housing loans as a percentage of total loans and advances