

21 February 2005

Committee Secretary
Parliamentary Joint Committee on Corporations
And Financial Services
Department of the Senate
Parliament House
Canberra ACT 2600

Dear Committee Secretary,

Re: Inquiry into regulation of property investment advice

The National Institute of Accountants (NIA), one of Australia's three professional accounting bodies, welcomes the inquiry into regulation of property investment advice. The NIA believes that the regulation of property investment advice should be addressed in a nationally coordinated manner and that where possible, that investment property advice be treated in a like manner to other forms of investment advice.

The enclosed NIA submission on this issue raises a number of concerns and suggestions. In particular the NIA would like to raise the following concerns:

- There is a need to ensure that those providing property investment advice are properly trained to give the advice they provide;
- There is a need to ensure greater independence in the advice that is provided and that all commission and fees are disclosed;
- That there should be nationally consistent legislation dealing with investment property advice; and
- The NIA is concerned at the level and quality of taxation advice that is being provided by those who are not registered tax agents.

The NIA believes that the regulation of property investment advice is a priority. Many more Australians now have property investments than in the past, and there is public concern that some of those who are providing property investment advice are doing so with little regard to consumers and the public as a whole.

If you have any questions or require any further information, please contact me either by phone on (03) 8665 3115 or by e-mail at reece.agland@nia.org.au.

Yours sincerely

Reece Agland
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Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into the regulation of property investment advice

The National Institute of Accountants (NIA) welcomes the inquiry into regulation of property investment advice. With the advent of the *Financial Services Reform Act 2001* (FSRA), most forms of investment advice are now regulated under the one Act. Property investment advice, however, has remained outside of this regime, in large part due to the constitutional framework. While the NIA appreciates the limited ability of the Federal Government to regulate all forms of property advice, the NIA is of the view that there is a need, at the minimum, to ensure greater consistency of legislation in the area and for a form of national coordination in regulating property advice. While the FSRA legislation is far from perfect, it does provide a basis from which reform of property investment advice can work from.

Effectiveness of current regulation

The NIA is of the opinion that the current regulation of property investment advice is not effective in protecting consumers from the worst elements of the industry. While many investment property advisors are keen to protect consumers, in order to protect the industry as a whole, there is widespread concern that some investment property advisors are only concerned with making a quick buck.

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. The Victorian Government's recent decision to change the law to protect the interests of property developers over the concerns of investors (through changing the law that would otherwise allow many investors who paid deposits to rescind their contracts) is a clear example of where their priority lies.

While most of the issues do relate to problems with the state laws, this does not mean that some changes to the current federal laws would not also help. The NIA believes that the *ASIC Act* could be amended to provide ASIC with greater powers to investigate whether property investment advice provided has or could breach elements of the FSRA.

The NIA, though, believes that tinkering with the current arrangements is not the most effective means for addressing concerns with the industry. See below for the NIA views on which type of regulatory changes the NIA believes will be most effective.

Concerns with the activities/behaviour of certain property investment advisors

There are concerns in the community that certain activities by the less scrupulous investment property advisors are designed to pressure people into making investment decisions they would otherwise not make. Of particular concern to the NIA are the following activities:

- *Provision of tax advice:* The NIA is concerned that a lot of false, misleading or poor tax advice is being provided as part of the advice and training packages offered by some in the industry. The taxation of property, as with most areas of tax, is quite complex. Each individual circumstance needs to be looked at and must take account of the overall financial and tax position of the persons involved. ATO audits in this area seem to indicate that a lot of new investment property owners do not understand their tax position. A lot of items are deducted as expenses by owners rather than treated as capital improvements. There are also problems with keeping appropriate records. Investors can face quite serious fines and interest charges for getting their tax wrong. It is, therefore, important that the provision of tax advice be improved and that investors check with a registered tax agent about the various tax consequences of their decisions. The ATO has signalled that deductions relating to investment properties will be heavily audited in the next few years.
- *Advice not taking into account the financial and educational position of investors:* The *Financial Services Reform Act 2001* requires that financial advisors covered by the Act must tailor their advice to the specific needs and circumstances of the client. Property advisors/training providers appear to provide a “one size fits all” approach, which does not take into account the different capabilities and financial position of their clients. This is a fundamental necessity. The NIA believes that it is important to require those providing advice in this area to tailor their advice to the requirements of the client and explain what factors they took into account in providing particular investment advice. There should also be some minimal training requirement on all people involved in this type of advice/training. It is required for other types of investment advice, so it should be required here.
- *Lack of independence by advice providers:* The accounting profession and other professions have very specific requirements in relation to independence. The FSRA requires independence for investment providers and requires that they divulge all connections and commissions (including indirect commissions) they receive in relation to the advice they provide. One of the problems with the advice providers/training providers is that they are often linked with providers of property. There are also often direct links with lenders (both to lend money to buy the properties and to pay for the extravagant fees to attend the “Education Seminars”). If such arrangements existed in other investment areas, they would be required to be notified up front or banned altogether. Property investment should not be treated any differently than other areas of investment advice in this regard. The NIA believes that all links and commissions between advice providers/training providers and those offering loans (whether it is for the courses or to purchase property) need to be made known clearly to all those involved. The NIA believes there should be a complete banning of advice providers/training providers offering property for investment where there is any connection between themselves and the property that is being offered. It creates a situation where the advice providers are in effect working for the seller of the property rather than for the person seeking the advice/training. This is a conflict of interest that the NIA does not believe is resolved by simply disclosing that there is a link between the two. It should be banned outright.
- *Lack of prescribed minimal training requirement:* The NIA is concerned that unlike other areas of financial advice, there is no mandated minimum training requirement for those giving advice in relation to property investment or those providing training courses. The NIA is concerned that the lack of accepted credentials means that the

quality of the advice/training that is provided is less than ideal and varies widely between different companies. The lack of prescribed minimum training is also likely to lead to a lowest common denominator approach, in that in order to reduce their costs, advice providers/trainers will make minimal investment in the education of their providers. Mandated minimal training requirements, while not solving all problems (such as the application of knowledge), will ensure that there is a common level of basic knowledge and greater consistency in the advice that is provided. The NIA believes that investment in real estate is no different than investment in other financial products. Therefore, just as the FSRA provides minimal training requirements for those in the financial services industry, those providing investment advice in relation to property should also have mandated minimum training.

- *“Education seminars”*: The NIA is particularly concerned with the ability of property investment advisors to sell property and get people into high levels of debt by dressing up their sales techniques as education. These education programs are often started by offering people free initial seminars in which the promoters often claim they will reveal the secrets to making millions in the property market. Once they have people there they tell them at the end of the free seminar that to gain a real insight and have access to “knowledge only the experts know” they have to sign up for expensive “training packages”. It appears from anecdotal evidence that there is heavy pressure for people to sign up to these training packages, and luckily for the participants, if they cannot afford the full cost now, they have payment packages just waiting for them. Another concern with these seminars is that the advice provided is not advice that is difficult to find. Most of it involves issues such as negative gearing and how to invest in multiple properties with limited down payments. Such advice could be had more cheaply from bank managers and/or accountants. While the fall of Henry Kaye and some other seminar providers has reduced the presence of such products in the marketplace, if laws are not changed, there could be a return to these unscrupulous behaviours.

While there are other areas of concern, these are the main areas of concern that the NIA believes need to be addressed. Any new provisions must be backed up by appropriate enforcement. The NIA believes that the only way to ensure that such enforcement is carried out in all states equally is for the states to transfer responsibility for enforcement to ASIC to undertake on their behalf.

Is it appropriate for property investment advisors to simultaneously sell an interest in property and financial products enabling such purchases?

As noted above, it is the view of the NIA that property investment advisors, as well as those offering “education” seminars, should not be able to provide instant financing arrangements. There is often a close relationship between the financial product provider and those selling the product. This means the advice is invariably not independent and that many of the normal checks and balances are not observed. Providing the two together also leads to greater pressure on the potential investors to sign up now to get the best deal. If the two were separated it would allow investors time to step away from the high pitch selling environment and to be able to think about whether the investment is a good idea for them. It will also mean that they are more likely to see an independent financial product provider who is more likely to provide them with independent advice.

The NIA would strongly support moves to ensure that those providing investment property advice or offering property investment seminars are not allowed to have on-site financial product providers.

Advantages/disadvantages of different models for reform

1) National coverage through uniform state and territory legislation:

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. To overcome this, the NIA believes that the model used in other areas of state-federal arrangement should be adopted. This will have the advantage that the laws in each state and territory are the same, and prevents the current situation of regulatory arbitrage, where differences in state laws are used to get around the law.

The NIA believes that state, territory and federal ministers, together with representatives of the community and interest groups, should come together to discuss and formulate the uniform set of laws. Such laws should address a range of issues in relation to property investment advice such as:

- Agreed definition of what property investment advice is;
- require licensing of advisors of such advice;
- Strong emphasis on independent advice;
- A uniform minimal educational/skills requirement on those providing investment property advice;
- Rules in relation to commissions and dealing with conflicts of interest;
- Prohibition on property investment advisors having commercial arrangements with financial product providers and prevention of financial product advisors being co-located within the premises of property investment advisors or at property investment seminars; and
- Community protection fund raised from license fees of all property investment advisors to cover losses incurred by investors from poor property investment advice.

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. As the regulator of the FSRA, ASIC has the requisite skills to enforce the new regime. While this would require the states ceding powers to a Commonwealth agency, it would seem to be the best means to ensure effective enforcement. The administration of the licensing would remain with the state governments.

The downside of such an arrangement is that it is dependent on the states being able to come to agreement on a uniform set of rules. This, though, has been able to be achieved in the past and should therefore not be too strong a disadvantage. It is important, though, that in coming to agreement a minimal system is avoided. Rather, the strongest possible set of laws should be agreed to.

2) Commonwealth legislation:

While having one law set federally would be the optimum outcome, the difficulties with the current constitutional arrangements means that it would be difficult to have effective Commonwealth laws. Any such Commonwealth law would face the prospect of legal challenges and thus would constantly be in doubt. Furthermore, the states already have existing measures dealing with certain property issues and thus have some expertise in the area. To ignore the role of state governments would do damage to the effectiveness of the measures.

3) Self-regulation:

Self-regulation works where there is a strong set of national principles which all participants in the industry share. Self-regulation also works where the industry involved has a strong focus on protecting consumer interest and on punishing those in their ranks who breach the industry rules. The accounting profession is one example of an effective self-regulatory model (though many aspects of the accounting industry are also regulated by the law and thus the profession is better described as being co-regulatory). The property investment sector does not seem to possess any of these attributes. There is no one single body that represents the interests of those involved. 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.

Conclusion

The NIA believes that the regulation of property investment advice is a priority. Many more Australians now have property investments than in the past, and there is public concern that some of those who are providing property investment advice are doing so with little regard to consumers and the public as a whole. The NIA supports moves that will bring greater regulation to the sector and supports a model based on a uniform set of state and territory laws, backed up by enforcement by ASIC as the best means to address the concerns of the public and to ensure greater professionalism amongst property investment advisors.