

**Parliamentary Joint Committee on Corporations and Financial Services  
Inquiry into the regulation of property investment advice by the Commonwealth**

**Submission of the Australian Securities and Investments Commission  
(February 2005)**

**Introduction**

The Australian Securities and Investments Commission [ASIC] welcomes the opportunity to provide this submission to the inquiry into regulation of property investment advice by the Commonwealth [the Inquiry] announced by the Parliamentary Joint Committee on Corporations and Financial Services [the Committee] on 8 December 2004.

Before considering the Terms of Reference for the Inquiry, we provide some background information regarding ASIC's jurisdiction and regulatory activities as they relate to the property investment area. We also draw the Committee's attention to the review of the financial advising activities of real estate agents undertaken by ASIC during 1999-2000.

As the Committee is aware, a Working Party of the Ministerial Council on Consumer Affairs is also currently considering the regulation of property investment advice. The MCCA Working Party (on which ASIC is represented) published a Discussion Paper, *Property Investment Advice*, in August 2004.<sup>1</sup> Reference is made to that Paper at a number of points in the course of these comments.

**Background information**

*ASIC's jurisdiction*

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. Broadly speaking, under the legislation we administer (in particular, Chapter 7 of the Corporations Act and Part 2, Division 2 of the ASIC Act), advisory activities in relation to real estate only come within ASIC's jurisdiction where advice is given about a *financial product* as defined by this legislation.

Thus, if an adviser gives advice about a property trust or other managed investment scheme, that advice will be a regulated activity. To take another example, in ASIC's view certain mezzanine mortgage products are also financial products for the purposes of our Corporations Act jurisdiction, and giving advice or promoting such products is therefore regulated. On the other hand, and this has not been fully appreciated, giving advice about direct investment in real estate is generally not regulated under the laws we administer.

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<sup>1</sup> Copies of this Paper may be accessed at the Ministerial Council on Consumer Affairs web site [www.consumer.gov.au](http://www.consumer.gov.au)

The MCCA Discussion Paper provides a fuller account of ASIC's jurisdiction in this area at 6.5 *Financial services laws*.<sup>2</sup>

### *Coordination with the ACCC*

As the general consumer protection regulator at the Federal level, the ACCC has responsibility for regulating real estate investment advice/ promotion under Parts VA and V of the Trade Practices Act. This is the case except where, as we have noted, the activity relates to a financial service and therefore comes within ASIC's responsibilities.<sup>3</sup>

As the Committee will appreciate, the activities of property promoters may, and frequently will, encompass both direct promotion of real estate and advice about credit or other financial products. In such cases, ASIC and the ACCC will each have jurisdiction in respect of different aspects of the activities of the particular promoter—as happened, for instance, in the Henry Kaye and National Investment Institute matter.<sup>4</sup>

A number of mechanisms and processes facilitate effective coordination of surveillance and enforcement activity between ASIC and the ACCC where, as with the property area, there is a degree of joint or overlapping jurisdiction. Firstly, each agency can delegate its powers to the other agency, and there is provision for standing cross delegations.<sup>5</sup>

Apart from this, there is close and regular liaison at Commission, Regional Commissioner and officer level, as well as through our joint participation in the Senior Officials of Consumer Affairs meetings and associated working parties. Moreover, to consolidate this inter-agency liaison, ASIC and the ACCC recently signed a new Memorandum of Understanding under which:

*The agencies agree to assist each other in the exchange of information, the referral of matters and the delegation of powers, and to cooperate on compliance, education and enforcement activities within the framework of this MOU and consistent with all relevant laws.*

The MOU sets out the processes for achieving these objectives in detail.<sup>6</sup>

### *Complaints received by ASIC*

ASIC has received a significant number of complaints about wealth creation schemes and promoters over the past three (calendar) years, a substantial proportion of which relate to property development schemes. Other forms of wealth creation complaints relate to share trading software packages, horse racing software packages and educational seminars and courses on superannuation, managed investments and other investment vehicles.

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<sup>2</sup> *ibid* at pp. 31-32

<sup>3</sup> *Financial services* was carved out of the Trade Practices Act, and therefore removed from the ACCC's jurisdiction, as part of the Government's Financial Services Reform program.

<sup>4</sup> See pp.2-3 below

<sup>5</sup> See s.26, Trade Practices Act and s.102(2)(e), ASIC Act for the respective delegations

<sup>6</sup> See ASIC MR 04-420 *ASIC and ACCC sign new MOU* (21 December 2004) which has a link to the MOU itself

In 2002, approximately 30 complaints were lodged. This increased sharply during 2003 when, leaving aside Henry Kaye and companies associated with him, there were 158 complaints, the majority of which related to property development schemes. There were also, during this period, over 400 complaints against Henry Kaye and associated companies, stimulated to a considerable extent by ASIC's high-profile enforcement action against Mr Kaye and those companies.

In 2004, the number of complaints in relation to wealth creation schemes increased to approximately 200. This represents approximately 2% of all complaints from the public received by ASIC. Of these, approximately half (93) sought to promote investment opportunities in the property market. Over the last quarter, however, complaints against property investment seminars fell relative to complaints against share trading software packages, a trend which no doubt reflects the cooling of the property market.

#### *Enforcement action*

ASIC's proceedings against Henry Kaye, the National Investment Institute and other related companies has already been referred to. The MCCA Discussion Paper provides an accurate summary of proceedings taken up to the time of the Paper's release in August 2004.<sup>7</sup> In addition, in September 2004 the Federal Court declared that Mr Kaye was involved in conduct that was misleading and deceptive, or likely to mislead or deceive, in relation to representations made by him concerning the compensation provisions of an enforceable undertaking provided to ASIC in July 2003.<sup>8</sup>

The MCCA Discussion Paper also summarises enforcement action in relation to other property promoters up to the middle of last year. Since then, we have continued to take action against wealth creation promoters and seminar presenters to restrain the provision of unlicensed advice about financial products by such promoters.<sup>9</sup> We also continue to take action against companies and individuals involved in illegal fund raising activities associated with property development.<sup>10</sup>

#### *Consumer education activities*

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<sup>7</sup> See Appendix A: Summary of Regulatory Action, under Australian Securities and Investments Commission at pp. 59-60.

<sup>8</sup> For more details see ASIC media release 04-284 *Federal Court declares Henry Kaye a party to misleading and deceptive conduct.*

<sup>9</sup> For more details see the following ASIC media releases: 04-239 *ASIC acts to protect consumers at Robert Allen's One Minute Millionaire seminar* (21 July 2004); 04-243 *ASIC ensures US speaker complies with the law* (27 July 2004); 04-322 *ASIC ensures wealth creation seminars comply with the law* (4 October 2004); 04-339 *ASIC restrains wealth creation spruikers* (18 October 2004); 04-344 *Gold Coast wealth creation seminar operator to cease illegal operations* (22 October 2004); 04-399 *ASIC acts against Gold Coast promoter of wealth creation seminars* (9 December 2004)

<sup>10</sup> For example, see the following ASIC media releases: 04-416 *Co-develop property schemes to be wound up* (17 December 2004), 05-16 *Adelaide directors appear in court over \$2.2 million investment scheme* (21 January 2005)

Apart from publicising our enforcement activities, ASIC has published extensive consumer education material on our consumer web site, FIDO, warning consumers and investors about the risks associated with get-rich-quick schemes and seminars.<sup>11</sup>

### **Review of financial advising activities of real estate agents by ASIC (1999-2000)**

During 1999-2000, ASIC undertook a review of the regulation of financial advising activities of real estate agents. ASIC was tasked with this review by the Government in response to a recommendation made in the Final Report of the Financial System Inquiry.<sup>12</sup> The review was limited to licensed real estate agents and did not cover the activities of unlicensed property marketers.

The key findings of the review<sup>13</sup> were that:

- the regulatory regime for real estate agents was not designed for the purpose of regulating the provision of financial advice by real estate agents, particularly individually tailored financial advice; *in consequence*,
- consumers did not have the benefit of the full range of safeguards available to them when they received investment advice about securities (under the then Corporations Law regime covering securities advisers).

The safeguards found *not* to be available to consumers in the real estate context included:

- competency requirements covering the giving of financial advice
- statutory liability of the licensee for the acts of its representative
- comprehensive requirements governing the disclosure of commissions and other benefits and interests
- warnings of the limitations on general advice
- a requirement to have a reasonable basis for recommendations where the investor's particular circumstances have been or should have been considered, and
- mandatory internal dispute resolution standards.

ASIC recommended, in summary, that requirements and standards *comparable* with those applying in relation to securities advice should be introduced to cover financial advice about real estate given to retail consumers. We made a number of suggestions as to how such comparability might be achieved, both as regards general advice provided as an incidental part of selling real estate and where the advice is (or purports to be) tailored to the investor's individual circumstances.<sup>14</sup> However, the review report did not make

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<sup>11</sup> To view this material, go to [www.fido.asic.gov.au](http://www.fido.asic.gov.au) and follow the links from *Get-rich-quick schemes*.

<sup>12</sup> Recommendation 16, *Financial System Inquiry Final Report*, (Mr S Wallis, Chairman), AGPS, Canberra, 1977, stated at p.275: The existing regulation of real estate agents should be reviewed. Real estate agents providing investment advice should be required to hold a financial advisory licence unless the review establishes the adequacy of existing regulation.

<sup>13</sup> See ASIC Media Release *ASIC Completes Review on Real Estate Agents* (14 February 2000) and attached summary

<sup>14</sup> *ibid*, under *ASIC's suggested approach to implementation*.

recommendations regarding possible regulatory responsibilities of the State and Territory and Commonwealth governments in this area.<sup>15</sup>

Implicit in our support for regulatory comparability was a view that 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. In both cases, we suggested, the financial considerations prompting investors to acquire, hold and divest assets are the same or similar. In addition, real estate and securities are, and are perceived by investors to be, interchangeable investment alternatives. We also noted that the risks associated with real estate investment were often higher given the generally high level of financial commitment required and the significant transaction costs associated with buying and selling real estate.<sup>16</sup>

### **Inquiry Terms of Reference**

In ASIC's view, the considerations referred to in the previous paragraph remain valid. They would also appear to be applicable irrespective of the type of person or entity giving financial advice about real estate—whether that person is a licensed real estate agent or their representative, a financial planner, an accountant or solicitor, or an unlicensed property promoter or wealth creation seminar operator.

Against this background, we turn to the topics listed under the Inquiry's Terms of Reference, and make the following brief responses:

#### *(a) Effectiveness of current regulation of the property investment advice industry in protecting consumers*

Generally speaking, advice about direct investment in real estate is regulated by the general consumer protection laws only. These laws are potentially effective where, among other situations, there has been misleading and deceptive conduct in the promotion of property investment schemes and seminars. Indeed, both ASIC and the ACCC have made considerable use of their respective powers under the Trade Practices Act and ASIC Act to intervene in cases where property marketers have allegedly engaged in misleading and deceptive conduct.<sup>17</sup> ASIC is also able to use its powers under Chapter 7 of the Corporations Act to restrain the provision of unlicensed advice about financial products, and has done so against promoters and seminar presenters on a number of occasions to date.<sup>18</sup>

However, it is doubtful, in our view, whether the current regulation of property investment advice does adequately protect consumers. For instance, on the basis of the

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<sup>15</sup> As the then ASIC Chairman (Alan Cameron) noted in the media release: "It is a matter for Governments to determine whether and how ASIC's recommendations should be implemented".

<sup>16</sup> These views are developed in the *Review of the financial advising activities of real estate agents*, Interim Report (July 1999), at p. 15ff

<sup>17</sup> In relation to ASIC, see under *Enforcement action* above

<sup>18</sup> *ibid*

complaints ASIC has received and the surveillance and enforcement work we have undertaken, we believe 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.<sup>19</sup> Under the general consumer protection laws there are, we would suggest, few regulatory incentives for promoters to make these positive disclosures.<sup>20</sup> As the Committee will be aware, this stands in marked contrast to the situation of someone providing either general or personal advice about a regulated financial product to a retail client—who is required to make these disclosures.<sup>21</sup>

More generally, it is doubtful whether a general consumer protection law regime alone can force advisers and promoters of property as a direct investment to address issues going to the quality and appropriateness of the advice they give. The MCCA Discussion Paper's discussion of competency/ quality of advice issues at 5.2,<sup>22</sup> including its references to a number of high risk financing arrangements, is based on the experience of the regulatory agencies on the working party, including ASIC.

Again, the contrast with the financial services regime is marked, both where general advice only is given and where tailored or personal advice (or what purports to be such) is given. As the Committee will be aware, under the financial services licensing regime licensees and their Authorised Representatives are subject to fitness and propriety requirements. They must also meet certain training and competency standards related to the nature of the advice they give. In addition, before providing services advisers must give their clients with a Financial Services Guide setting out certain information including the disclosures referred to above.

Further requirements also apply depending on whether the advice provided is general advice only or personal advice. In the latter case, a financial adviser is required to have a reasonable basis for the advice they give. As part of this, they must undertake whatever researches and inquiries are necessary to ensure that any product they recommend is appropriate to the client's needs and objectives. Generally, the adviser's advice, and the basis for that advice, must be set out in a written Statement of Advice. These requirements do not apply where general advice only is given (as, typically, in the investment seminar scenario). However, there is a statutory obligation to warn clients about the limitations of general advice in this situation.

There are no comparable requirements applying in the direct property investment context. We submit that, in the absence of at least some of these mechanisms, it is unlikely that quality of advice issues, such as those referred to in the MCCA Paper, can be effectively addressed.

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<sup>19</sup> See also MCCA Discussion Paper at pp. 18, 23

<sup>20</sup> However, in limited circumstances a positive disclosure may be necessary to ensure that a representation is not misleading and deceptive.

<sup>21</sup> See Part 7.7, Div 2, Corporations Act, including s. 942B(2)(e),(f) and s. 942C(2)(f)(g)

<sup>22</sup> See pp. 21-23

Finally, we would emphasise that, 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.

*(b) Alleged behaviour of property investment advisers*

As the previous response indicates, ASIC's experience is that the types of behaviour itemised under this term of reference have been associated with wealth creation seminars and schemes in varying degrees in recent years. In general, we consider the description of these operators set out Parts 4 and 5 of the MCCA Discussion Paper to be accurate.

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

Property investment advisers should only advise on or deal in products regulated under Chapter 7, Corporations Act, if they are licensed or authorised to do so. Generally, credit facilities are not regulated products for the purposes of the Corporations Act regime<sup>23</sup> (although ASIC has responsibility for the regulation of conduct relating to credit facilities under the general consumer protection provisions of the ASIC Act<sup>24</sup>).

As the Committee will be aware, it is quite common in many areas of trade and commerce for a trader or supplier to offer to arrange finance for a potential purchaser. The trader will usually have a linked credit arrangement with a bank or finance company allowing it to offer this service. We suggest that the existence of such arrangements in the property investment market is to be expected and is not *per se* problematic. The real issue, alluded to above, is the nature and appropriateness of the financing arrangements being promoted and whether the risks associated with particular financing arrangements are brought home sufficiently to potential retail investors.

*(d) Advantages and disadvantages of identified law reform models*

We do not propose to comment on this issue. Questions of regulatory responsibility are matters of high-level policy and are appropriately dealt with by government policy agencies, as distinct from a regulatory body such as ASIC.

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<sup>23</sup> s.765A(1)(h)(i) of the Act specifically excludes *credit facilities within the meaning of the regulations* from the definition of a financial product under Chapter 7, Corporations Act

<sup>24</sup> A credit facility (within the meaning of the regulations) is specifically included within the definition of a financial product under the ASIC Act: see s. 12BAA(7)(k)

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

As the Committee is aware, one of the requirements of Australian Financial Services Licence holders is that they have a dispute resolution system meeting the statutory requirements.<sup>25</sup> This includes having a compliant internal dispute resolution procedure, and belonging to an ASIC-approved external dispute resolution scheme. These requirements reflect the Parliament's recognition of the considerable barriers to access to the Court system for consumers of financial services. Similar alternative dispute resolution mechanisms operate in other areas of trade and commerce as well—for instance in the telecommunication and utility sectors.

We suggest that access to redress may also be an issue in the real estate sector. In this context, we note that one of the common complaints to ASIC regarding property promoters has been in relation to claiming promised 'money-back guarantees' where the consumer is not satisfied with a seminar or other investor education service they have purchased. In our experience, and this is also reflected in the MCCA Discussion Paper,<sup>26</sup> operators generally do not have adequate internal complaint-handling processes. Moreover, for most consumers taking legal action to recover fees will not be viable given the amounts involved and the risks and costs associated with litigation.

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<sup>25</sup> See s.912A(1)(g) and s.912A(2), Corporations Act

<sup>26</sup> at pp. 18, 25