



17 November 2004

Property Investment Advice Working Party
Office of Fair Trading
GPO Box 3111
BRISBANE QLD 4001
By e-mail: OFT-P&L@dtftwid.qld.gov.au

Dear Sir/Madam

Thank you for the opportunity to comment on the Working Party's *Property Investment Advice Discussion Paper*. I apologise for the delay in providing the attached submission.

Credit Union Services Corporation (Australia) Ltd (CUSCAL) is the main industry body for credit unions. CUSCAL provides industry association and commercial services to 150 of Australia's 172 credit unions. Credit unions are Authorised Deposit-taking Institutions (ADIs) that are owned by their customers and are focused on providing excellent personal service. Credit unions have total assets of \$30 billion and 3.5 million members.

Each credit union holds an Australian Financial Services Licence (AFSL) and is subject to the licensing, conduct and disclosure obligations of the Financial Services Reform Act (FSRA).

The FSRA requirements are in addition to the licensing and prudential regulatory requirements imposed on ADIs by the Australian Prudential Regulation Authority (APRA) under the *Banking Act 1959*.

Credit unions are also subject to the Uniform Consumer Credit Code (UCCC) and its obligation to ensure consumers have a capacity to pay before finalising a credit contract.

In making this submission to the Ministerial Council on Consumer Affairs Working Party, CUSCAL draws on its experience in policy debates about Federal/State responsibilities and consumer protection legislation.

Please don't hesitate to contact me on 02 6232 6666 if you wish to discuss any aspect of the submission.

Yours sincerely

LUKE LAWLER
Senior Adviser, Policy and Public Affairs

**SUBMISSION BY CREDIT UNION SERVICES CORPORATION (AUSTRALIA)
LIMITED (CUSCAL) TO THE MINISTERIAL COUNCIL ON CONSUMER AFFAIRS
WORKING PARTY**

PROPERTY INVESTMENT ADVICE DISCUSSION PAPER

Executive summary

CUSCAL supports the principle that regulation should be targeted at areas of genuine consumer risk.

There is no convincing case to distinguish the consumer protection regulation of property investment advice from other forms of investment advice.

It is a mockery of regulatory and consumer protection principles that prudentially-regulated, low-risk investments such as deposits are subject to a stringent consumer-protection licensing regime while high-risk property investments are virtually unregulated.

The Discussion Paper makes the compelling observation that the average Australian investor has more money tied up directly in real estate investments than in directly held sharemarket investment.

“Importantly, too, real estate investments are more narrowly held than their sharemarket equivalents – an investor is likely to have just one or two investment properties, versus a wide portfolio of shares. This obviously increases the potential detrimental impact of a poor investment decision on individual investors,” the discussion paper says.

Property investment advice should be subject to licensing, disclosure and conduct requirements of the FSRA.

The alternative approach of the States and Territories introducing their own licensing and disclosure regimes is inefficient and these regimes may be inconsistent between States and Territories and with the FSRA. A new and distinct layer of investor-protection regulation would risk unnecessarily increasing the regulatory compliance burden on law-abiding businesses.

Retail investors and the property market

CUSCAL generally agrees with the discussion paper’s description of developments in the property market and with the “significant problems” associated with the provision of property investment advice and wealth creation services.

CUSCAL’s proposed solution to problems such as poor advice, exaggerated claims, non-disclosure of information and lack of dispute resolution is to bring property investment advice under the FSRA umbrella.

Currently, property is not a “financial product” for the purposes of FSRA.

A financial product is a legislative term that encompasses making a financial investment, managing a financial risk, and making non-cash payments.

According to notes at s763B of the *Corporations Act 2001*, real property does not fit within the legislated definition of a “financial product” because “while the property...may generate a return for the person, it is not a return generated by the use of the purchase money by another person.”

This means property investors are not making a financial investment when they buy real property.

This distinction would be lost on most consumers. However, anyone can see there is a gaping breach in consumer protection regulation.

It means that investors buying units in a property trust are making a financial investment. A school student opening a savings account is making a financial investment. But people making the biggest investments of their lives, i.e. buying property, are not making a financial investment and are therefore outside the licensing, conduct and disclosure laws that protect other investors.

The process of saving a deposit to obtain a loan to make a property investment is fully covered by the investor protection laws, but in making the much larger investment to buy the property the consumer is unprotected.

The depositor is protected by a regime that imposes elaborate disclosure and licensing obligations (such as dispute resolution) on providers that are concurrently subject to an entirely separate but equally stringent prudential regime that ensures that there is almost no risk to the investment. However, the property investor, generally with much more at stake, is at the mercy of a virtually unregulated market. (Investment property buyers do not even have the protection of the UCCC that is provided to residential property buyers.)

Any reasonable observer must find it absurd to have strong licensing and disclosure protection for investors in low-risk products but no such protection for investors making what may be the biggest investment of their lives.

Investment advice

As the long property boom was taking off in 1997, the need for regulation of property investment advice was recognised in the Final Report of the Financial System Inquiry (FSI).

The FSI said that real estate agents promoting negatively geared investment packages were providing retail financial advice and, subject to a review of the adequacy of existing regulatory arrangements, they should be required to hold an investment adviser’s licence.¹

ASIC’s subsequent review 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.”²

¹ FSI Final Report, 1997. p275.

² ASIC review on real estate agents, 2000. Summary, p2.

Real estate agents and property spruikers may be reluctant to submit to the licensing, disclosure and conduct obligations that flow from dealing in, or advising on, “a financial product.”

Reluctance about being subject to FSRA is not surprising. In CUSCAL’s view, the FSI’s 1996 Discussion Paper was chillingly prescient when it made the following observation:

“Often, it appears that in translating goals to regulatory requirements, consumers’ real needs are lost or neglected. For example, suppliers may have imposed on them requirements which result in more information or procedures than consumers can readily use, with the resulting cost or confusion being borne by the latter.”³

Unfortunately, this is what happened with FSRA.

However, if the FSRA regime is viewed as onerous, impractical or inflexible, the response should be to improve FSRA rather than leave certain classes of investors (eg property investors) unprotected.

Credit unions, as AFS licensees living with FSRA, are not impressed by an argument that some consumers should be left unprotected by FSRA because compliance with FSRA is too complex and burdensome. As CUSCAL continues to argue in other forums, the solution lies in better implementation of FSRA’s objectives.

We have no sympathy with the view that “high intensity” regulation is appropriate for advisers on savings accounts and debit cards, but not for advisers on property investment.

Inconsistent regimes

The alternative to bringing property investment within FSRA is for the States and Territories to introduce their own “mini-FSRAs” specifically to cover property investment.

CUSCAL is concerned that such an approach will create the risk that investor-protection regulatory regimes will be inconsistent between the States and Territories and inconsistent with the Federal laws regulating all other investments.

Prior to 1999 the deposit-taking and lending business of credit unions was regulated by 8 different state and territory licensing and corporate registration regimes. This was known as the Financial Institutions (FI) Scheme and it was criticised in the Financial System Inquiry Final Report as “duplicative, cumbersome and costly.”

“While the FI Scheme has raised the prudential standing of institutions supervised, it has failed to deliver uniformity, cost efficiency or regulatory neutrality either across industries supervised or with competitors in the wider financial system.”⁴

This experience supports the case for regulation of property investment advice to be a Federal responsibility.

What is critical is that people giving property investment advice, regardless of whether they are real estate agents or wealth seminar spruikers, are subject to appropriate licensing, conduct and disclosure requirements.

³ FSI Discussion Paper, 1996. p261.

⁴ FSI Final Report, 1997. p307.

This means minimum competency requirements for advisers, dispute resolution schemes and, for an industry riddled with conflicts of interest, full disclosure of who is being paid by whom and how much.

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16 February 2005

The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Suite SG.64
Parliament House
Canberra ACT 2600
By e-mail: corporations.joint@aph.gov.au

Dear Committee Secretary

Inquiry into regulation of property investment advice

Credit Union Services Corporation (CUSCAL) is the main industry body for credit unions, representing almost 90% of credit unions by number and more than 80% of the sector by assets.

Please accept as CUSCAL's submission to the Committee's inquiry our recent submission to the Property Investment Advice Working Party of the Ministerial Council on Consumer Affairs.

I can be contacted on 02 6232 6666 or 0418 213 025.

Your sincerely

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