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3 March 2005

The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Suite SG.64
Parliament House
CANBERRA ACT 2600
By post & email: corporations.joint@aph.gov.au

Dear Sir/Madam

Inquiry into Regulation of Property Investment Advice

CPA Australia and The Institute of Chartered Accountants in Australia ('the Accounting Bodies') welcome the opportunity to make a submission to the Inquiry into regulation of Property Investment Advisors.

This submission has been prepared by our Legislation Review Board (LRB). The LRB is administered by the Australian Accounting Research Foundation, which is a joint initiative of CPA Australia and ICAA. The LRB is appointed to advise on matters of legislative and regulatory policy affecting financial reporting, auditing and corporate governance.

The Accounting Bodies do not support further regulation at this stage, believing that further research is needed in two key areas before any recommendations can be made.

Firstly, further research is needed into how widespread the problems are of not having regulations. Secondly, if there are problems that need to be addressed through regulatory reforms, a better understanding is needed of the effectiveness of the Financial Services Reform Act (FSRA) in addressing advice related issues. These issues have been further developed in the attached submission.

Should you wish to discuss this submission further, please contact Jan Macpherson, Project Manager – Legislation Review, on Tel: (03) 9885 4748.

Yours sincerely

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Stuart A Black, FCA
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c.c. J Macpherson

PARLIAMENT OF AUSTRALIA
Joint Committee

Inquiry into Regulation of Property Investment Advice

CPA Australia ('CPA') and Institute of Chartered Accountants in Australia ('ICAA'), together form the Accounting Bodies and appreciate the opportunity to comment on the Inquiry into the regulation of property investment advice.

This response has been prepared by our Legislative Review Board (LRB), which is under the administration of the Australian Accounting Research Foundation. The LRB is appointed to advise on matters of legislative and regulatory policy affecting financial reporting, auditing and corporate governance.

In November 2004, the Accounting Bodies provided a submission to the Ministerial Council on Consumer Affairs Working Party supporting a regulatory regime that is similar to that which operates for other investment advisors. Since that time, the accounting bodies have given considerable further thought to the issue of regulation of property advice and is reconsidering its position.

The Accounting Bodies believe further research is needed in two key areas before any recommendations can be made.

Firstly, further research is needed into how widespread the problems are of not having regulations. Property advice is provided by a wide range of groups including property developers, real estate agents, financial planners, accountants and lawyers. The type of advice varies considerably, from recommendations relating to a specific property to more general advice about investing in property as part of a more comprehensive portfolio. A better understanding is needed of if whether problems are isolated to one group of adviser or particular type of advice before recommendations can be made about introducing legislation that could potentially have a wide impact.

Secondly, if there are problems that need to be addressed through regulatory reforms, a better understanding is needed of the effectiveness of the Financial Services Reform Act (FSRA) in addressing advice related issues. There is an opportunity to learn from implementation issues faced with FSRA .

At this stage, we are not able to provide responses to many of the specific issues being explored by the Joint Committee on Corporations and Financial Services. However, CPA Australia has already commenced work on some research into these issues and intends to have the results available by the end of May 2005. We would welcome the opportunity to provide a more considered submission, once we have had time to take the results of this research into consideration.

Background

Regulation of investment advice has been the subject of enormous change over the past decade, with the most significant change being the introduction of the Financial Services Reform Act (FSRA) in 2002.

The Accounting Bodies supported the introduction of FSRA to address the inconsistencies in the old licensing regimes and ensure enhanced consumer protection. However, since the introduction of FSRA a range of issues have emerged about how the legislation works in practice. One of the best examples of this is the requirements relating to Statements of Advice. In theory the Statement of Advice was intended to provide clear, concise and effective disclosure for consumers. In reality, consumers are receiving lengthy documents which are not easily understood as the planner seeks to protect *themselves* from complaints by the consumer and ensure the onerous disclosure requirements of FSRA are met.

It has been nearly 12 months since FSRA has been in full effect, but we don't have a real sense of whether the objectives of FSRA have been met.

- Are consumers better protected?
- Are consumers receiving useful information on which to make an informed decision?
- Has the quality of advice improved?
- Have there been increases to the cost of obtaining advice? If so, are the increases such that financial advice is becoming cost-prohibitive for the very people FSRA was introduced to protect?

The accounting bodies believe further research is needed into the effectiveness of FSRA in achieving its objectives before similar regulations are introduced in other areas that may not prove to be effective.

Responses to the specific terms of reference

- a) *The effectiveness of current regulation (including the Trade Practices Act 1974, the ASIC Act and the Corporations Act 2001) of the property investment advice industry in protecting consumers.*

At present there are only minimal regulations of the property investment advice industry.

1. There is currently no disclosure or at best inadequate disclosure of conflicts of interest or potential conflicts of interest.

2. Advisory services to retail and prospective investors have no regulatory controls and little barriers to entry into the property investment advisory services arena.
3. Enhanced returns for investors have little to do with property investment advisory services and more to do with the general market place.

However, the impact of these reduced regulations is not known. While there are certainly instances where consumers have been disadvantaged as a result of lack of regulation in this industry, the Accounting Bodies are not in a position to recommend additional regulation of the entire property advice industry when the need for consumer protection is not known.

- b) Allegations that property investment advisors engage in behaviour including:***
- i) characterisation of their activities in order to avoid regulation;***
 - ii) habitual use of high pressure selling techniques in order to induce investment decisions;***
 - iii) failure to disclose interests they may have in properties they are selling;***
 - iv) failure to disclose commissions and fees associated with their services;***
 - v) failure to provide appropriate disclosure of downside risk associated with the property or financial products they recommend***

If the allegations mentioned above are proven and are widespread, regulation would not only seem appropriate but necessary. However, the Accounting Bodies are not aware of any data that quantifies the extent to which these allegations are true.

In assessing the allegations, it will be critical that a distinction is made between different types of 'property investment related advisory service', 'property investment advisor' and 'investment advice'.

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

When considering this issue, it is unclear what is meant by the term 'financial products'. Advice relating to financial products such as shares, managed investments and superannuation are regulated under FSRA, where stringent licensing and disclosure requirements already apply. However, the most common 'financial

product' used to enable the purchase of a property will be a mortgage, which is not a product currently regulated under FSRA.

Advice relating to mortgages and other sources of finance is currently the subject of a Discussion Paper issued by the Office of Fair Trading on National Finance Broking Regulation.

As the concerns arising from this issue equally apply when advice is provided in other areas, such as advice in relation to shares and margin loans that could be used to purchase those shares, the Accounting Bodies believe it is more appropriate to address this issue as part of National Finance Broking Regulation review rather than isolating it in this review which is focusing only on property advice.

- d) advantages and disadvantages of possible models for reform of the property investment advice industry including:*
- i national coverage through uniform state and territory legislation;*
 - ii Commonwealth legislation; and*
 - iii a scheme of self-regulation of property investment advisors on a national basis*

If regulations were to be introduced, there are several advantages to introducing uniform regulations, whether they are through any of the options outlined above or otherwise. These include:

- ensuring minimum training and qualifications of those providing advice;
- enhanced consumer protection;
- enhanced disclosure and information;
- consistency of advice across Australia; and
- consistency of advice and information with other forms of investment such as shares and managed funds.

However, until such time as further research is undertaken to determine the need for regulation, the significant costs that will inevitably be incurred and eventually passed on to the consumer are unnecessary.

Any regulatory scheme would need to address penalties and redress mechanisms.

If a regulatory scheme is proposed, the Accounting Bodies would seek delegation of accreditation and disciplinary functions to professional accounting bodies where advice on property investment was given in the normal course of an accountant's

business, with the overall scheme regulator setting benchmarks for and monitoring the performance of those professional bodies.

- e) *whether current legal processes provide effective and easily accessible remedies to consumers in dispute with property investment advisors.*

No. The difficulty with the current legal processes is that by the time consumers realise the problems the loss has been suffered and the property investment advisor may be out of the business. If they are still trading, the only main redress consumers have is through the courts - a process that is lengthy and costly, with a high degree of uncertainty over the outcome.