



24 February 2005

The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Suite SG.64
Parliament House
Canberra
ACT 2600

Submission on the Parliamentary Joint Committee Inquiry into regulation of the timeshare industry

We thank you for your invitation to participate in the Inquiry. We note that the Australian Timeshare and Holiday Ownership Council ("ATHOC") is, or will be, delivering a submission on behalf of the timeshare industry. We have actively participated in discussions within ATHOC on the submission and do endorse that submission. However, we also felt it appropriate to submit a separate submission which would be more focused on issues that directly affect our business.

Executive summary

Our submissions can be summarised as follows:

1. Labeling timeshare as a financial product and managed investment scheme, while may be correct legally and conceptually, runs the risk of confusing and misleading the public in thinking that timeshare is similar to other investment-linked financial products.
2. The Australian Financial Services licensing requirements are onerous and cost-prohibitive, thus have the unintended consequence of reserving the market for large corporations. The minimum standards prescribed for responsible officers prevents diversity in the management of timeshare.
3. The compliance imposition requires clarification and directions from the regulators so as to reduce costs and unnecessary burden.
4. The level of competency training imposed by PS146 is too high and the focus needs re-alignment to core product knowledge.
5. Some of the disclosure requirements, such as financial services guide, statement of advice and the 'know your client' rule are inappropriate.
6. The prescribed cooling off regime is not intended by the legislature, and is more onerous than those prescribed for liquid schemes. A cooling off regime is necessary for timeshare but it should not be more onerous than that imposed on liquid schemes.
7. We believe that the requirements set out in section 3.7 below are more than adequate and effective in protecting consumers of timeshare products.
8. We are not in favour of self-regulation or separate state and territory legislations.

9. Timeshare should be regulated by the Commonwealth within the overall framework of the Corporations Act but without labeling it as managed investment scheme or financial product. It should have a separate chapter within the Corporations Act with relevant consumer protection provisions but dispensed with the irrelevant financial product related requirements.

1. Brief background on Trendwest South Pacific

We are a subsidiary of Cendant Corporation (NYSE:CD), a top 50 publicly traded company based in New York. Cendant is a leading provider of travel, hospitality services and residential real estate services.

We commenced operations here in Australia early 2000. We were the first timeshare company to receive a dealer's licence to manage and operate a timeshare club regulated as a managed investment scheme under the newly enacted chapter 5C of the Corporations Act. In over 4 years we have become the leading timeshare company in Australia and the South Pacific, with 400 resort apartments in 10 locations (Cairns, Sunshine Coast, Gold Coast, Coffs Harbour, Port Macquarie, Port Stephens, Hunter Valley, Ballarat, Denarau Island in Fiji, and Rotorua in New Zealand) owned and used by over 24,000 owners in Australia, New Zealand and Fiji. Our staff numbers have grown to over 1000. Based on the Gold Coast, we have offices in Brisbane, Sydney, Melbourne and Auckland, New Zealand.

In February 2003 we were granted an Australian Financial Services licence (Number 225200) to provide financial advice, deal in a financial product and operate a managed investment scheme.

2. Terms of reference

You have asked us to comment on the following:

- The effectiveness of the current regulatory arrangements for the timeshare industry under the Corporations Act 2001, including:
 - Whether the current regulatory arrangements are confusing to consumers and inhibit the development of the industry;
 - Whether the current regulatory arrangements place an undue compliance cost on the industry;
 - Whether the current regulatory arrangements are effective in protecting consumers of timeshare products.
- Advantages and disadvantages of possible models for reform of the regulatory arrangements applying to the timeshare industry, including:
 - Self-regulation of the industry on a national basis;
 - Alternatives to coverage under the Corporations Act 2001, either by separate Commonwealth legislation or state and territory legislation.

3. Effectiveness of the current regulatory arrangements for the timeshare industry under the Corporations Act 2001

Timeshare is regulated under two separate chapters of the Corporations Act, namely Chapter 5C and Chapter 7. The former deals with the operation of timeshare as a managed investment

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scheme and the latter sets out the licensing and operations of timeshare as a financial product.

The fundamental premise of treating timeshare as a managed investment scheme, and thus a financial product, has the consequence of trying to fit a 'square peg in a round hole', resulting in confusion among the consumers and the operators, and in escalating compliance time and costs.

3.1 Identity burden

Timeshare is fundamentally a holiday and leisure product notwithstanding that there is a general pooling of funds to generate mutual benefits. However, defining it as a managed investment scheme and a financial product inevitably causes consumers to draw the conclusion that timeshare is an investment-linked product. This is neither the intention nor the case. ASIC Policy Statement 66 expressly forbids timeshare promoters to represent timeshare as an 'investment'.

At the timeshare sales presentation, we provide attendees with a copy of the financial services guide and product disclosure document when they check in at reception. This is even before we have the chance to sit down with the guests and explain timeshare to them. Invariably the guests on receipt of the financial services guide would draw a conclusion that timeshare is a financial product and as such there must be an investment link. This conclusion is further compounded when they read that timeshare is a managed investment scheme (emphasis ours) and is regulated by ASIC. We have many of our guests commenting 'I know this is not designed to make money for me but why is it called a managed investment scheme?' The lay public would not have the knowledge to know why timeshare is legally a managed investment scheme. To avoid being in breach of PS 66, the timeshare adviser has to constantly reiterate to the guests that timeshare is not a financial investment. This not only confuses the guests even more but detracts the adviser from spending his or her time explaining the features of the product.

3.2 Licensing burden

To sell timeshare, we are required to hold an Australian Financial Services Licence. There are three parts to our licence: provide financial product advice; deal in a financial product; and operate a registered managed investment scheme.

The licence application process is complex and requires the production of tomes of 'proofs' which are either irrelevant or disproportionately onerous for the sale of a holiday/leisure product. We were required to submit the following proofs:

1. Responsible officers - their qualifications, experience and skills;
2. Development program for responsible officers;
3. Compliance arrangements - compliance plan for the timeshare scheme, compliance plan for the responsible entity, and risk management plan for the responsible entity and the timeshare scheme;
4. If we outsource any services (eg, audit, legal etc), how do we engage, brief and monitor these external service providers;
5. Program for training, supervising and monitoring the staff;
6. Financial resources;
7. Human resources capacity;
8. Information technology capacity;
9. Dispute resolution scheme;

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10. Risk management system;
11. Compensation capacity - insurance;
12. Research statement;
13. Scheme operating capacity;
14. Scheme property;
15. Funds under management;
16. Product distribution channel;

Emphasis was placed on the qualifications, experience and skills of the responsible officers. Our applicants were required to answer questionnaires relating to whether they have been involved in businesses dealing with securities, stocks, futures, commodities, superannuation and insurance. Each of them was also required to demonstrate whether they satisfy one of 5 alternatives for meeting the organisational competency obligations.

- Alternative 1 requires the applicant to meet the standards set by APRA AND to have at least 3 years relevant experience in the past 5 years;
- Alternative 2 requires individual assessment at full diploma level, relevant to the particular industry AND to have at least 5 years relevant experience in the immediate past 8 years;
- Alternative 3 requires a university degree in a discipline relevant to the activities AND an approved relevant short industry course listed in the ASIC Training Register AND at least 3 years relevant experience in the past 5 years;
- Alternative 4 requires a qualification specifically relevant to the industry at a recognised diploma level AND at least 3 years relevant experience; and
- Alternative 5 allows the applicant to convince ASIC that he or she has the relevant credentials and experience to do the job.

It is submitted that the prescribed standards are onerous and are not entirely relevant to the timeshare industry. During the course of the application, one could not help coming to conclusion that while the licensing officer(s) demonstrated helpfulness and preparedness to understand the industry, they did not appear to have a clear understanding of the differences between timeshare and other financial products and they applied to a certain extent, the same yardsticks applicable to pure investment-linked products.

After a long period of dormancy, timeshare is now active again. However there is a dearth of management who would be able to comply with the minimum level of experience required by the above alternatives. Much has also been said about getting rid of the old timeshare bad habits. By insisting on a responsible officer to have minimum 3 years of timeshare experience pre-empts professional managers with no or limited timeshare experience, from providing diverse business acumen to the improvement of the industry.

Trendwest spent more than \$500,000 in legal and associated fees when it applied for its dealers' licence in 2000. One of the conditions imposed on the dealers' licence was the requirement of its responsible officer to complete two papers in financial planning and superannuation. This is an indication of the absurdity of the regulatory arrangements.

When transiting into the AFS licence in 2003, Trendwest spent more than \$200,000 in legal and associated fees on the application.

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The high costs involved in obtaining a licence present a huge barrier and have the unintended consequence of reserving the market for large corporations only.

3.3 Compliance burden

As briefly alluded to above, we were required to produce two compliance plans - one for the timeshare scheme and the other for the Responsible Entity, and a risk management plan. The responsible entity functions as a manager and trustee of the scheme. Its primary obligations are to ensure that the club is managed properly, hence to a large extent the compliance processes in its compliance plan would be identical with those set out in the scheme's compliance plan. Similarly, inherent in compliance plans are risk management processes. There were no clarifications on these apparent duplications which created additional burden and costs.

Another potential duplication is in the area of audit. Chapter 5C requires the compliance plan to be audited annually. Chapter 7 requires the financial conditions set out in the AFS licence to be audited. The Corporations Act in general requires the business affairs of the Responsible Entity to be audited. The financial conditions set out in our AFS licence must also be captured in the compliance plan. As a result we have two firms of auditors auditing the same financial conditions. Since the main business of the Responsible Entity is the management of the timeshare scheme, we have the situation of the auditors for the Responsible Entity going through the compliance plan to ensure that there are no issues which could affect the business of the Responsible Entity, the very same audit conducted by the compliance plan auditors.

Last year Trendwest spent more than \$1 million on compliance. This include staff wages, compliance committee fees, audit fees, printing costs for the product disclosure statement and financial services guide, PS146 training costs, monthly mystery shops costs, and regular training and monitoring programs. SMEs would struggle to spend that kind of moneys on compliance.

3.4 Training and monitoring burden

This is discussed more extensively in ATHOC's submission. Trendwest assisted in the drafting of the timeshare knowledge section of the Timeshare Education Program. We believe that the mandatory requirement on timeshare advisers to know the economic environment, operation of financial markets, different types of financial products and managed investment products is potentially dangerous and risky as they confuse the advisers and the public as to the true features of timeshare.

Trendwest spends more than \$10,000 per annum enrolling its representatives in the Timeshare Education Program and ASIC filing fees. In addition, we have a dedicated person who spends 25% of her duties doing the enrolments and ASIC filing. The training and assessments are done by team managers and dedicated in-house assessors. Trendwest believes that if the training criteria are reduced from Tier 1 level to Tier 2 level, the process could be more simplified and less time consuming. The training time could be reduced, the candidates would focus only on the relevant materials, and the test could be done on-line dispensing with manual marking.

Trendwest is perhaps the only timeshare company in Australia that requires its advisers to sit a monthly on-line test which focuses principally on the timeshare product it is issuing. It is a focused training tool and keeps the advisers regularly apprised of the product they are selling.

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To reduce the risk that our advisers, armed with 'investment' knowledge from the Timeshare Education Program, may inadvertently provide investment advice, Trendwest has invested heavily in a mystery shopping program to monitor the adviser's conduct. Trendwest spends in excess of \$250,000 annually on its mystery shopping program.

3.5 Disclosure burden

We endorse the submission made by ATHOC on the relevance of the Financial Services Guide, the 'Know Your Client' rule, and the Statement of Advice in timeshare. Both the Financial Services Guide and the Statement of Advice are inappropriate as they confuse and mislead the recipients in thinking that they are acquiring an investment-linked product.

The 'know your client' rule in the context of timeshare is only relevant in competitive marketing analytics and strategies, and should not be a legal or regulatory imposition.

3.6 Cooling Off

With the advent of financial services reform provisions, a consumer may return the financial product and have his or her money refunded within a 14 day period starting on the earlier of the time when the transaction is confirmed or at the end of the 5th day on which the product was issued or sold to the consumer. Regulations were then promulgated which excluded the application of the cooling off regime to illiquid schemes. As timeshare is by definition, an illiquid scheme, the legislature must have intended that the cooling off regime is not to apply. However, ASIC issued a class order (applicable only to timeshare) and imposed conditions on timeshare licences, which set out cooling off requirements for timeshare only. These cooling off requirements contain the following elements:

- A cooling off period of not less than 10 business days but in the case of the responsible entity being a member of ATHOC, 5 business days;
- A cooling off statement must be disclosed in the application form as well as in the Product Disclosure Statement;
- The application for timeshare must be accompanied by a separate cooling off statement in a prescribed form approved by ASIC;
- The separate cooling off statement must be signed by the applicant acknowledging receipt of the statement;
- The responsible entity must maintain written records relating to the issue of all cooling off statements.

These requirements are far more onerous than the requirements set out in Chapter 7 for liquid schemes.

It is submitted that the legislature has no intention of subjecting timeshare as an illiquid scheme, to cooling off requirements set out in Chapter 7. However, if timeshare is to be singled out for separate treatment, then it is submitted that the cooling off requirements should not be any more onerous than those applicable to liquid schemes as set out in chapter 7. The conditions set out in the class order and imposed on timeshare licences should be removed. As a member of ATHOC, the standard 14 days cooling off period should be reduced to 7 days.

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3.7 Consumer protection

The issues set out in paragraphs 3.1 to 3.6 are ineffective in consumer protection. On the contrary, they confuse or mislead consumers.

We believe the following requirements are more than adequate and effective in protecting consumers of timeshare products:

- A workable and rigorous compliance plan which also contains risk management processes;
- A clear, concise and informative product disclosure statement;
- Timely provision of the product disclosure statement to consumers;
- A cooling off period to consumers;
- A robust internal complaints handling system with right to refer to an external complaints handling body;
- Regular training and testing of the sales staff on product knowledge and trade practices provisions.

4. Other possible models

4.1 Self-regulation

Trendwest at this stage is not supportive of self-regulation of the industry on a national basis. The industry is just becoming active. There are presently not enough resources to support self-regulation.

4.2 State and Territory legislation

Trendwest is also not in favour of separate state and territory legislation. Its parent company's compliance costs in United States where timeshare is regulated on a state-by-state basis are evidence of the legal complexity and bureaucratic burden imposed by state legislations.

4.3 Commonwealth legislation

Trendwest believes that the timeshare industry in Australia should continue to be regulated by the Commonwealth within the overall framework of the Corporations Act with the override that to avoid being confusingly tagged together with investment-linked products, a separate chapter within the Corporations Act should be enacted to deal solely with timeshare. Such chapter would address timeshare as a holiday/leisure product with the relevant consumer protection provisions but would dispense with the irrelevant financial product related provisions as identified above.

5. Conclusion

Trendwest appreciates the conduct of this Inquiry. We believe that addressing the issues raised in this submission, would eliminate the risk of confusion and misrepresentation, reduce

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the compliance costs, legitimise timeshare as a holiday/leisure product, and yet continue to protect consumers from any risky trade practices.

We are aware of the federal government's desire to make further modifications and refinements to the financial services reforms in response to business complaints about the compliance costs. This Inquiry could be timely. However we do hope that the issues raised by the timeshare industry would not be 'lost' or 'set aside' whilst attention is given to appease the banks and fund managers, they being bigger businesses than timeshare.

Any queries or clarification required regarding this submission can be directed to:

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Yours faithfully
Trendwest Resorts South Pacific Limited

A handwritten signature in black ink, appearing to read 'Barry', with a large, stylized flourish extending to the right.

Barry Robinson
President and CEO

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