

Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (a)

**Submission No. 154 (Supplementary to
Submission No. 131)**

Submittor: Mr Arnold Sierink
on behalf of a group of people
affected by solicitors mortgage
schemes in Tasmania
644 Dorans Road
SANDFORD TAS 7020

- SUPPLEMENTARY -
SUBMISSION TO THE SENATE SELECT COMMITTEE ON
SUPERANNUATION AND FINANCIAL SERVICES

A GROUP OF PEOPLE AFFECTED
ARNOLD SIERINK ON BEHALF OF THE ~~ASSOCIATION OF~~
~~INDEPENDENT RETIREES~~ BY SOLICITORS MORTGAGE SCHEMES
IN TASMANIA

(amended
by
submitter
14/5/01)

PARTIES

Australian Securities and Investment Commission - ASIC (ASC)
Financial Planning Association - FPA
Financial Industry Complaints Service Ltd - FICS
Solicitors' First Mortgage Schemes - SFMS's
Piggott Wood and Baker - PWB
Lewis Driscoll and Bull - LDB
Murdoch Clarke Cosgrove and Drake - MCCD
Association of Independent Retirees - AIR
Australian Broadcasting Commission - ABC

1 INTRODUCTION

- 1.1 The number of people affected by collapsing SFMS's in Tasmania has been conservatively estimated at approximately 300 with an estimated \$20m of lost capital. With compound interest this figure will be higher.
- 1.2 An invitation was made in the September 2000 newsletter of the Hobart branch of the AIR. For affected members to stay behind following the end of the next public meeting. Subsequently a small group of approximately 12 people lobbied on behalf of deprived investors to the Premier of Tasmania Jim Bacon, without success. Opposition members Ray Groom and Sue Napier asked questions and raised this issue as a matter of public interest in Parliament on 22nd March 2001. This initial action has led to a concerted media campaign in the Hobart *Mercury* for an unprecedented 6 weeks with the running title of *Lawyers' Funds Fiasco*. Investigations by both ASIC and Tasmania Police into aspects of the collapses has intensified.
- 1.3 The Law Society has expressed concern about the scale of the reaction against Tasmanian law firms in the wake of the fiasco. President of the Law Society of Tasmania, Phillip Jackson commented in a circular letter sent to all practitioners.

*It is fair to say that it is a long time since the legal profession in this State has been under such sustained attack, if ever it has been.*¹

- 1.4 The problems affecting failed SFMS's operated by law firms LDB, McCulloch & McCulloch, PWB and others have caused senior Liberal politician and former Attorney General, Ray Groom, himself a lawyer, to say that the *Lawyers' Funds Fiasco* "...is tarnishing the reputation of lawyers".
- 1.5 Edward Sikk, a former Crown prosecutor and retired magistrate stated in the media: "I cannot recall when lawyers have been held in less esteem".²

2. THE EXTENT OF THE PROBLEM

- 2.1 While the Law Society has disputed the figure of \$20m saying that losses are unlikely to be anywhere near that figure, anecdotal evidence supports losses of this magnitude if not more.
- 2.2 Losses are currently increasing exponentially for investors who in many cases have not received interest on their capital for three years. Even small losses of capital will dramatically increase with the compounding effect of lost interest on that initial capital outlay. The total loss must include the loss arising from the inability of investors to take advantage of present investment opportunities due to their money being retained by the law firms in question.
- 2.3 As well as the lost interest on the money which investors might have realized if they were able to invest their capital elsewhere, consideration must be given to the further financial damage which will occur as the situation drags on. Costs involved in fighting to have money returned can be substantial even for those who are engaged in lobbying rather than actual litigation. People who suffer a sudden change in their financial circumstances will be diminishing their own capital in meeting basic living expenses. Investors deprived of part of their funds might be expected to incur additional costs in adjusting to their new impoverished situation.
- 2.4 For instance people on fixed incomes can suffer devastating losses with even the slightest reduction in that income. Some people without the additional income to pay rates and insurance may be forced to sell their homes, at a loss in a collapsing real-estate market. Some investors are now having to contemplate this prospect. Elderly people in Tasmania could buy a small unit advantageously in the present climate but will not be able to do so because their money is no longer available to them. The health problems, and related expenses of retirees are also likely to be compounded, with the associated emotional costs, if funds are not available for

¹ Letter from Phillip Jackson of the Law Society of Tasmania to legal practitioners dated 27th April 2001.

² *The Mercury*, Letter to the Editor from Edward Sikk

them to undertake necessary elective surgery. The additional costs of this sort of problem will flow onto the entire community.

2.5 In his circular to practitioners, Law Society President Phillip Jackson says:

There may be losses. It is impossible to put a figure on those at this stage but on the evidence and advice presently available to the Society it can be said quite unequivocally that if there are losses, they are most unlikely to be anywhere near \$20m.

2.6 This comment illustrates the fact that lawyers appear unable to understand that investors have already experienced serious loss. They experienced loss when they could not withdraw their own money on one month's notice as promised by the various firms. The attitude of Mr Jackson as a representative of all Tasmanian lawyers seems lacking in appreciation for the real plight of investors, suddenly deprived of access to their own life savings.

2.7 The main reason why this matter of deprived investors needs to be resolved immediately is in order to prevent further financial damage to vulnerable investors who should not have to wait another day for return of their funds.

2.8 The true extent of the problem is likely to be difficult to gauge. There is a tendency for victims to not come forward because of the shame and guilt which many victims feel.

2.9 To some extent this embarrassment arises directly from the feeling that they have placed their trust in a friend and confidante who has betrayed them. In some cases husbands are not aware that their wives have lost money and vice versa. Parents are not disclosing to children that they have lost family funds. This isolation and the resulting inability to access support services compounds the health and social problems of people who have been suddenly left bereft by the improper retention of trust fund monies.

2.10 This emotional and psychological strain is not alleviated by agencies such as FICS telling victims who were clients of a licensed financial planning provider that they should have made more inquiries about the nature of their investments. Other public comments by the FPA on ABC *Stateline* on the 20th of April 2001 that investors were "greedy" in looking for the highest possible return also appear to be an example of the general tendency to "blame the victim". The rate of return to investors in solicitor's mortgage funds would appear to be generally only 1 to 1 ½ % above that of the long term bank rate.

3 TRUST AND THE DUTY OF CARE

3.1 Much of the community outrage around these collapses arises from strong feelings about the dispossession of innocent investors who are in many cases

elderly, alone and in some cases - infirm and who totally reliant on the income from their investments. In a small state like Tasmania most people would know of at least one person who has been treated in this way. The insular nature of the society in this state means that the reputation of lawyers in general is not likely to recover from community anger about the expropriation of the life savings of victims. This community perception of the behaviour of "despicable" lawyers will impact on community attitudes to the justice system in general as feelings that lawyers are untrustworthy will flow over into their other activities as officers of the courts.

- 3.2 It was faith and trust in lawyers which caused many of the victims to part with their hard earned savings to SFMS's in the first place. Many of these victims had pre-existing relationships with legal firms and invested money on the basis of a trusting relationship they had built up both with individual partners and the firm itself over many years.
- 3.3 While some investors' funds were placed into SFMS's through ASIC licensed financial advisers, the situation is similar, in that some investors had long term relationships with these advisers because of workplace retirement/redundancy seminars. These advisers were paid by investors to research the bona fides of the recommended investments. Some advisers appear to have been blinded by the traditional trust placed in the legal profession.
- 3.4 Those offering financial services are required to comply with Corporations Law. The SFMS's were exempted by ASIC from complying with the Corporations Law upon request of Law Societies Australia wide, who were able to convince a public hearing on 26th March 1992 that they had sufficient prudential controls. These included a self-regulatory body, a fidelity fund and professional indemnity insurance, and also that there was a vetting of lawyers through entry qualifications.
- 3.5 The facts are that the prudential oversight relied on by The Law Society of Tasmania in obtaining that exemption have not been implemented and SMFS operators appear to have been able to make up their own rules about how investors' funds were managed.
- 3.6 Investors were devastated to find that trusted solicitors and financial advisers had not told them that their money was being invested in risky commercial and subdivision developments rather than "bricks and mortar" and consider this to have been a serious breach of trust. Another area of concern is that law firms placed investors' money in non-performing loans. For example PWB confirmed in writing to one investor :

The question is whether or not the loan was a performing loan at the time your funds were put into the loan. Having said that, I believe that the loan was in fact non-performing at the time your monies were put in it.³

- 3.7 The failure to fully explain the "Conditions of Investment Form" was another failure in the solicitors' duty of care to their clients. Many investors signed forms put in front of them by office staff without any explanation of the terms and conditions on the investment.
- 3.8 This lack of explanation of the finer legal points of the loan agreement became apparent when investors later obtained independent legal advice after law firm PWB failed to return investors' money after the specified one months' notice in writing.
- 3.9 The investors' lawyer requested the return of capital on the basis that "one month's notice is required for both partial and total withdrawal of the funds". PWB lawyer Leigh Sealy replied with the opinion as to what "one month's notice" meant in legal terms:

*In our view this statement does not imply that one month's notice is all that is required for the withdrawal of funds. Rather it sets out a requirement or pre-condition for the **withdrawal** of funds. It says nothing at all about the **availability** of funds.⁴*

- 3.10 This kind of semantic nit-picking is exactly why it is not reasonable to expect victims to go through the court system to recover funds. Lawyers in a situation where they are enriched by someone else's money are in the privileged position of being able to resist almost any rational argument put up by the victim. Anyone who attempts to fight this sort of convoluted logic knows that they are in for a protracted and expensive battle. Litigation is prohibitive for most people who have lost their savings particularly if they are elderly as they could conceivably die before the matter is ever dealt with in the court system.
- 3.11 Many investors advanced money to financial advisers such as Garrisons, who then invested the funds into SFMS's. These investors trusted that these firms would act professionally because of their ASIC accreditation and membership of the FPA. The problem appears to be that these firms failed to effectively research the security held by the solicitors' mortgage funds on behalf of investors.
- 3.12 While some of these people have been told by regulators that they should have examined their investment properties more closely, these investors feel that if they have paid licensed financial advisors to make their investments then they should be able to feel confident that those advisors will act professionally.

³ Letter from PWB to an unnamed investor, 26th November 1998.

⁴ Letter from PWB to an unnamed investor 15th December 1998.

4 THE LAW SOCIETY RESPONSIBILITY

4.1 The Law Society of Tasmania submitted to ASC that it should be exempt from complying with the Corporations Law at a public hearing on 26th March 1992.

4.2 The Law Society of Tasmania argued that its system of public complaints meant that it would have early notice of any problems in SFMS's. The Society pointed to its powers to direct a legal practitioner to produce his or her books of account to an accountant and a solicitor and the trust accounts of the firm could be made subject to management by nominees of the Society. However these powers have generally not been used or have been applied too late to protect investors.

4.3 The Society in its argument claimed that :

In the view of the Society, when loss is occasioned in the course of taking mortgage security by reason of some act of negligence on the part of the solicitor concerned it is only an isolated transaction which will be affected. That being so then, in all but the most extreme cases of rare, very large mortgages, the cover so provided will be sufficient to ensure indemnification of the investor with only a sum of excess to be paid by the solicitor concerned.

4.4 In this paragraph the Law Society is indicating that in the case of a shortfall in investors' funds that the practitioner should pay the excess. Is the Law Society going to insist that lawyers' themselves should make up the difference in investors' funds?

4.5 The Law Society in its arguments before ASIC also stressed the supervisory and investigatory role of the Society.

....it is extremely unlikely that any deficiency could occur on such a scale as to leave any member of the public without full compensation.

4.6 Did the Law Society deceive ASIC about its ability to provide an effective regulatory framework in order to protect investor funds? An investigation needs to be conducted to see if the assertions of the Law Society to the ASIC public hearing in 1992 were based on fact or whether these statements were made recklessly to the hearing without regard for the necessity for accuracy and truth.

4.7 For instance who are the trust account inspectors appointed by the Law Society of Tasmania and what evidence is there of these trust account inspectors examining the books of the defaulting legal firms? If the Council had monitored the accounting records of the firms which operated mortgage schemes then why did they not pick up the situation where investors' savings were placed with borrowers with a history of default in interest payments?

5 AFTERMATH

- 5.1 Dispossessed investors have had to approach the Department of Social Security for the first time in their lives in order to obtain money to live on. However some were told when they approached the Department for assistance that a pension was not available to them as they had investments. One Centrelink official told a 65 year old retiree who had lost her life savings of \$65,000 that the whole fiasco was "your fault for not investing in the correct place".
- 5.2 The extent of this problem needs to be investigated for the health and well-being of elderly people who may be in need of assistance and who are unlikely to be able to obtain that assistance through available governmental or charitable organizations. This is primarily because of their own feelings of pride and self-sufficiency and also because these organizations may have little understanding of the personal situation of deprived investors.
- 5.3 The potential for an increase in the numbers of people approaching Centrelink for assistance could mean that it may be cost-effective for the Commonwealth itself, perhaps through Centrelink, to actively assist retirees and other vulnerable groups deprived of income from investments, in pursuing defaulting trustees for recovery of investments either through the provision of legal advice through in-house lawyers or through the provision of additional legal aid.

6 OVERVALUATION

- 6.1 Overvaluation was a major factor in investor losses. One development valued at approximately \$4.3m in 1998 was sold in 2000 for \$820,000. In some instances the borrower paid the valuer. In another case a 15 month old valuation was used.
- 6.2 In the case of the LDB disaster, much of the overvaluation was achieved by the irregular actions of the local council in sealing a subdivision. This subdivision went from a valuation of \$223,000 to \$802,000 in one year with limited work done on that subdivision. To add insult to injury the council is attempting to claim \$203,000 worth of outstanding rates on this over inflated subdivision from the investors' remaining capital.
- 6.3 Although the Law Society carried out an audit on LDB's mortgage early 1998 this over-valuation must have been "overlooked" by the auditors as no apparent action was taken by the Law Society as more investors' money disappeared into that subdivision.⁵
- 6.4 The problem of overvaluation appears to arise from a complex set of relationships between surveyors, valuers, local council officers, the Land Titles Office, solicitors, financiers and developers etcetera. The factors which lead to overvaluation are most likely to come into play in the financing of greenfields development sites. The causes of this overvaluation are not easy to define. For

⁵ Letter MCCD to Sorrell Council 29th June 1998.

instance while PWB have taken legal action against the valuer who provided the valuation for the Bridport development, the valuer advised PWB to obtain another valuation in 12 months' time – which they failed to do. The groups involved in commercial development appear to be interdependent and their interests seem to be best served by overvaluation rather than undervaluation because overvaluation encourages initial investment.

- 6.5 It would seem therefore that any attempts at prudential regulation should start from a basis of understanding the mechanisms of overvaluation of property through the interaction of the major groups involved in property development. It would also seem that the investors' main concerns about not being told that their money was going into commercial developments are soundly based. The failure of solicitors to inform investors that they had embarked on property speculation was a primary cause of losses. The failure of solicitors to initially identify the property by address also misled investors as they were not able to physically inspect the properties. For example investors whose money was lent to Everworth (Tas) Pty Ltd were not aware that they were lending to the troubled resort, Rutherglen.

7 CLAWING BACK FUNDS

- 7.1 Deprived investors find that because of the situation where they are treated as though they are the mere beneficiaries of a trust that they are unable to exert any influence on law firms in order to claw back any funds at all from the borrowers.
- 7.2 Investors in the Sunny Hills development found that PWB were embarking on costly litigation to sue the valuer, without the consent, of affected investors.
- 7.3 In the same development, the proceeds of sale from land associated with the development was not returned directly to investors but was retained by the law firm to assist in the marketing of the remainder of the estate.

8 CONCLUSION

- 8.1 While there have been examples of problems with SFMS's in Tasmania in the past it is unlikely that victims are going to continue to suffer in silence. Present day technology means that small groups of deprived investors can combine and act in order to expose the administrative and systemic failures which lead to collapses of this nature. Until their capital and interest are returned in full investors have nothing to lose by vigorously pursuing their funds by whatever means are at their disposal. The loss of public confidence in both the legal system and the system of public regulation in general is likely to be extensive.
- 8.2 The submission before you is therefore concerned with seeking the immediate return of all withheld capital and interest. As this is "our money" this does not seem to be too much to ask.

- 8.3 As far as future changes to the prudential supervision and consumer protection for superannuation, banking and financial services is concerned it would seem as if despite an extraordinary amount of money being spent on regulatory bodies the situation is still likely to occur again perhaps a general national insurance scheme to protect superannuation funds could be established.
- 8.4 The collapse of solicitors' mortgage funds in Tasmania illustrates that words are not enough to protect the savings of vulnerable groups. Accountability must be clearly defined without any possibility of misinterpretation. All financial investment depends on trust and faith in the professional ethics of the person you are dealing with across the table. *The Lawyers' Funds Fiasco* undermines confidence in investing in Tasmanian infrastructure.
- 8.5 Basic trust and faith needs to be restored. This can only be achieved by the regulators -ASIC and The Law Society of Tasmania -working together to return to affected investors, the outstanding capital and interest.

A. J. Jervis

7-5-2001