



# **Senate Select Committee on Superannuation and Financial Services**

## **Main Inquiry Reference (a)**

### **Submission No. 202**

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**GARRISONS PTY LTD**

**SUBMISSION TO SELECT COMMITTEE ON  
SUPERANNUATION AND FINANCIAL SERVICES**

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**SOLICITORS FIRST MORTGAGE SCHEMES IN AUSTRALIA**

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## EXPLANATORY NOTE

This submission is provided by Garrisons Pty Ltd (ABN No. 50009 556 370) "Garrisons" to assist the conduct of the Senate Select Committee Inquiry into prudential supervision and consumer protection for superannuation, banking and financial services, including a case study into solicitors mortgage schemes in Tasmania.

Accordingly, the information provided is in Garrisons capacity as a leading financial planning organisation in Australia. A number of Garrisons clients have been exposed to potential losses arising from the failure of a small number of mortgage schemes operated by solicitors in Hobart.

The information contained in this submission reflects information and explanations obtained from documents provided to Garrisons, Garrisons internal records and discussions with a range of parties in Tasmania who have had experience with the operation of the solicitors mortgage schemes over many years. Much of the information has been gathered from external sources and therefore we would not be in a position to attest to the completeness or accuracy of that information. We do, however, include this in our submission, as we believe it is relevant to your Inquiry.

For your information, in November 1999, Garrisons was acquired by Challenger International Ltd which manages around \$1.2 Billion in mortgage investment products in Australia and has \$7 billion Funds under Management.

## HOW GARRISONS IS ADDRESSING THIS PROBLEM FOR ITS CLIENTS

Garrisons has been concerned for some time about the level of anxiety this matter has caused for its affected clients. Garrisons feels that individual investors are not in a strong position to take on claims against lawyers. With clients' capital locked away in illiquid or defaulting funds, with little prospect of reaching a timely solution with the lawyers, Garrisons felt it could play a constructive role in finding a practical solution to resolve this matter for its clients.

On Tuesday 12 June 2001, Garrisons wrote to affected clients, detailing an offer to immediately return their capital and pursue the return of outstanding interest on their behalf, subject to their agreement to hand over their Solicitors First Mortgage Fund entitlement to Garrisons.

Initial response from clients has been extremely positive to date.

## INTRODUCTION

The Senate Inquiry has expressed its concerns over why some solicitors first mortgage schemes in Tasmania have failed. It is necessary to look at the roles and responsibilities of the parties to these schemes and the actual product itself. We have detailed our understanding of the roles of various parties in Appendix A.

Traditionally, solicitor first mortgage funds have been a sound and reliable investment alternative for many Tasmanians. Like any investment product, its performance is dependent on the promoters of the product abiding by the rules that relate to the product distribution and administration. The rules governing the administration of all financial products are externally regulated and controlled.

In the case of solicitors mortgage products in Tasmania, it is clear that where the rules governing the operation of this product have been abided by, by the parties responsible for the product, there has been, since the introduction of the Corporations Law and its regulatory requirements, little or no problems outside the normal commercial risks.

There have been a few firms of solicitors in Tasmania who, in recent times, either have not or appear to have not, abided by their own Rules of Practice.

The firms that Garrisons has experienced difficulties with include:

1. Lewis Driscoll & Bull (LDB)
2. McCulloch & McCulloch (MM)
3. Piggott Wood & Baker (PWB)

To our knowledge, these are the only firms that have caused distress to our clients and these are the only firms who have created potential losses due to the operation of solicitors mortgage schemes. We are aware of some problems with particular investments in Ware and Partners and Henry Wherrett & Benjamin but these appear to be isolated instances with what we understand are good opportunities for full recovery and we are informed there will be little capital risk to investors. There have been, and are, a multitude of other solicitors mortgage schemes run by reputable law firms that have provided, and continue to provide, sound and reliable investment products for their clients.

## THE TASMANIAN MARKET PLACE

In excess of 30 solicitor firms in Tasmania have promoted solicitor first mortgage investments.

The public perception, which is substantially supported by the track record of the performance of these investments has been that they have been managed by professional persons who have fulfilled their obligations to mortgagees and mortgagors alike. There has, up until 1998, been little or no public experience of the failure of the schemes arising out of fraud, defalcation or other commercial reasons with the exception of Macquarie Law when the Solicitors Guarantee Fund returned 100% of the capital of investors in that fund. Indeed, because these schemes were managed by the legal profession, with a range of safeguards including the Solicitors

Guarantee Fund, investors regarded these investments generally as secure and personally managed by the partners of the firms. Experienced financial advisors, many of whom had long-term successful professional dealings with these schemes that were producing good returns for their clients, held similar beliefs.

There is substantial evidence to support the investors and advisors belief that these products were secure when they were run in accordance with the Rules of Practice.

In 1998, it became apparent that some solicitors mortgage schemes were not being run in accordance with the rules of practice. The reasons for this failure to abide by the rules subsequently became clear.

In 1998/99 Garrisons held discussions with the Department of Justice, The Law Society and the Attorney General, which estimated that around \$650 million was invested by investors (predominantly Tasmanian) through solicitors mortgage schemes run by a large number of practices in Tasmania.

It was also clear that the Managed Investments Act implemented on 1 July 1998 would require promoters of the operation of these funds to either comply with the requirements of that Act by 1 November 1999 or wind up the scheme. A wind up of the scheme would mean no new investment monies could be received and the promoters would have a 2-year period (to November 2001) to dispose of the underlying investment appropriately.

Within this regulatory environment the Law Society was working with its members to assist this process. Simultaneously, it became public knowledge that three firms were experiencing substantial difficulties.

## **GENERAL COMMENTS ON THE TASMANIAN FIRMS**

Individually the failure of some firms and the problems of liquidity and defaulting mortgages of the other firms could be absorbed in the Tasmanian economy. Collectively these events, which were unfortunately close in occurrence, created a potential for the public to have serious concerns over the operations of all solicitors mortgage funds in Tasmania.

This problem heightened in early 1999 and included extensive media coverage, public meetings and proposed investor actions against the legal firms.

A major concern for investors and advisors in early 1999 was that collectively the events described above, could inevitably lead to an uncontrolled run on all solicitors mortgage funds in Tasmania whereby all investors would be requesting redemption of their monies. This would have been disastrous for the Tasmanian economy for the following reasons:

- There was not sufficient liquidity for all investors to immediately redeem their monies
- The nature of mortgage investments does not enable this process to occur
- A run on all mortgage products would inadvertently affect the performance of all mortgage funds
- Losses would unnecessarily be incurred by investors through the asset realisation process

- The efforts of other providers registered under the Management Investment Act and willing to accept solicitors mortgage products would be substantially hindered.

The nature of these potential losses would arise not only from the failed mortgage schemes but other solicitors mortgages that were performing efficiently.

In relation to the specific letter sent to us by the Select Committee on Superannuation and Financial Services dated 1 June 2001, we make the following comments.

## **OUTLINE GARRISONS EVALUATION OF SOLICITORS' MORTGAGE SCHEMES PRIOR TO PLACEMENT OF CLIENTS' MONIES IN THESE.**

Garrisons has a number of clients who have had and currently have investments in Solicitors First Mortgage products. A substantial amount of these investments were made around 1995 after the bond market crash which saw conservative investors with capital stable investments experience negative returns.

Solicitor First Mortgage investments were not explicitly included on Garrisons approved list of investments as it was believed that these investments were not securities as defined under s. 92 of the Corporations Law. Garrisons formed this view because they were regulated by the Law Society of Tasmania under the Rules of Practice and not under the Corporations Law. They were also viewed as secure, good yielding and non-volatile investments.

Although the products were not on the approved list, research was conducted.

As a licensed dealer in securities, Garrisons has its own research department with suitably qualified employees. Their full time responsibility is to research products that are either

- (i) recommended for advisor use and included on the Garrisons recommended list
- (ii) available for use by advisors but not included on the recommended list
- (iii) products specifically requested to be used by either advisors or advisors clients (which may or may not be subsequently approved)

Generally only ASIC regulated products are included on the recommended list. However, in the case of solicitor mortgages which have not been ASIC regulated, these were separately researched.

The role of research is an ongoing one which requires regular review of all products being used by the advisors. The research department looks at both risk and return characteristics and particularly the performance over time of all products. As a consequence of this process, products are regularly included and deleted from those available for advisor use.

It is important to note that even if Garrisons or an advisor does not recommend a particular product, but the client instructs them to invest in that product, they may place that investment on behalf of the client but formally waive responsibility for the performance of that product. This is quite a common occurrence for a number of reasons including;

- The moral / ethical bias of investors (eg ethical or green environmental funds)
- Pre-existing investments
- Desire to invest in Tasmania (community issues)
- Personal relationships (family / business)



As this is quite a common feature of client's requirements, the research department is not able to fully evaluate this potential range of investments.

In the mid 1990's, a number of Garrisons advisors in Hobart successfully used solicitors mortgage investments to provide appropriate returns to their clients. These schemes were used in conjunction with other investment strategies for their clients.

Research included gaining an understanding of the safeguards in place to protect the client's investments.

It was reasonable to expect to place reliance on the lending rules as promulgated, enforced and monitored by the Law Society in Tasmania, and widely accepted by the public and the Australian Securities & Investments Commission (ASIC). In particular, the following safeguards were a key to recommending the SMF's:

- a) The Law Society of Tasmania had a role in monitoring SMF's through appointed Account Inspectors.
- b) The Legal Practitioner's Act and the Rules of Practice were applied to solicitors offering SMF's.
- c) The Supreme Court and the Solicitors Trust administered the Solicitors Guarantee Fund which would compensate investors for any capital losses in the case of defalcation, misappropriation or misapplication of their funds.
- d) Professional indemnity insurance, being a mandatory requirement of all solicitors holding practicing certificates, would protect investors.
- e) Inspections were conducted on mortgage practices and the results were advised to the Law Society of Tasmania.
- f) Conservative lending ratios (66% of valuation) and stable property prices, assuming proper valuations, reduced the risk of losses of capital.
- g) Lending took place only against first mortgages on real property in Tasmania, which have relatively less volatile prices than other parts of Australia.

Garrisons research noted that "SMF's attracted class order exemptions partially on the basis that supervision by legal professional associations should have meant that funds were operated in a satisfactory manner". This was the research department's advice to advisors as a result of the above understandings.

Specifically, Garrisons advisers undertook specific research before investing clients funds. The following is an exert from the work undertaken by Mark Hudson in relation to his recommendations of solicitor first mortgage funds:

**General Research Conducted Included:**

- Personal investment and involvement in three SFMF (including prior to 1994)
- An understanding of the product;
- An understanding of the way the product was regulated, including perusing the Legal Practitioners Act, and the Rules of Practice regulated by the Law Society of Tasmania.

- An understanding of the history of the product and the associated risk factors;
- The use of registered valuers to obtain reliable valuations of real property in Tasmania.
- Reputation of the legal profession in Tasmania as a whole and the partners of the individual firms;
- The fact that the Law Society had a Fidelity Fund to cover any capital losses in the event of a breach by a practicing solicitor;
- The fact that property prices in Tasmania were and are very conservative and less volatile than other states.
- Available information through professional publications Information available in the general domain.
- Information available in the general domain

**Specific Research Conducted Included:**

- Due enquires of each legal firm to gain an understanding of their credibility, background, amount of funds managed, and how long the practice had been managing a SFMF;
- I only dealt with legal firms in southern Tasmania (with the exception of one legal firm which was specifically requested to be retained by the client) in which I had a reasonable business relationship with. This included an understanding of the way the practitioners operated and conducted their business, their reputation within the Tasmanian business community and the strength of their firm;
- Due enquiry as to the security of the investment, in the case of PWB, I was informed by Michael Burke that the partners guaranteed the interest in the event of a default and on at least 2 occasions was also informed that the partners guaranteed the principal in the event of a default. Letters of comfort were obtained from each practice which confirmed they continued to meet the requirements of the Law Society;
- I relied upon the fact that the Law Society regulated the funds and appointed an auditor to audit the funds to ensure my clients funds were invested in accordance with the Act;
- I also relied upon the fact that the software used in administrating SFMF's was first approved by the Law Society and audited by a qualified auditor.
- For all SFMF recommended, I had a good business relationship with each partner and or representative and made regular enquiries of the funds. Such enquires included:
  - Meetings with the partners and or representatives of the legal firms to question:
    - Time frame before forwarded funds could be invested
    - Time frame of accessibility
    - Borrower profile
    - History of Forced-sales
    - Plus all other specific research conducted including their track record etc.

Immediately prior to December 1998, and as a consequence of the ASIC policy proposal paper in October 1998 calling for industry submissions on how SMF's should be regulated under the Corporations Law, Garrisons updated its position in a binding research policy (policy no. 5) on solicitors mortgage funds.

The research conducted behind this paper came from discussions with several industry participants (including some law societies) and with ASIC. In the preparation of this up to date research and to explain the radical industry changes that had led to this re-evaluation which indicated that the position in respect to solicitors mortgage funds had at the time of this report recently and significantly changed it was advised to planners that:

- "Major structural change in the lending industry over the last few years has created greater competition and lower margins among lenders."
- SMF's have almost become a lender of last resort as a result of these changes. In particular, since low risk borrowers can now obtain relatively cheap loans elsewhere, SMF's have experienced a pronounced move away from lower risk residential lending to higher risk commercial lending.
- Many solicitors have a lack of skill in mortgage lending (especially in the area of credit risk assessment)
- Investors using SMF's have not adjusted their expectations of those funds in line with structural changes in the industry. The days of a "safe" 8% - 10% return are over, for the time being, and those funds still offering those levels of return are providing it at the cost of considerably increased risk.
- Unfortunately, it is now becoming evident how significant these problems are. There are many reports of funds in default across the country and we continue to receive anecdotal evidence of new casualties on a monthly basis.
- Despite the fact that many funds are probably well managed, in our view the removal of the class order exemptions and the introduction of the Managed Investments Act are positive developments in the context of the problems being experienced."

Garrisons research recommended a controlled exit programme and advisors looked to redeem client's funds as mortgages matured rather than let them roll over.

**This research document was prepared prior to any detailed public or other knowledge about the problems associated with Lewis Driscoll & Bull and Piggott Wood & Baker.**

There were a number of unfortunate circumstances that individually could be managed but collectively has created, in hindsight, substantial problems for persons with investments in solicitors first mortgages. Garrisons, once it became aware of these additional risk characteristics which were not present when the initial investments were made, recommended the appropriate action to its advisors.

Circumstances did not enable that strategy to be fully implemented because of:

- The publicity subsequently given to the Lewis Driscoll & Bull fund
- The inappropriate actions of certain solicitors

**After the introduction of Garrisons policy in December 1998, no further recommendation for investments into solicitors mortgage schemes were made by Garrisons advisors.**

Because of the timing of a range of events that led to the failure of these funds and because of the actions of certain solicitors, any further research (if any further was actually possible) would be highly unlikely to result in any change to the research department's advice to advisors at any point in time.

### **ONGOING REPORTS FROM SOLICITORS' MORTGAGE SCHEMES IN GARRISONS OUTLINING PERFORMANCE OF THESE SCHEMES AFTER GARRISONS PLACED MONIES IN THEM.**

The firms of solicitors were the promoters and the administrators of these schemes. Their responsibilities included:

- receiving investors monies either directly or through financial advisors
- fiduciary duties arising from holding monies on trust for investors
- placing those monies in investments under the guidelines required by their rules of practice, ie
  - i. up to 66% of security valuation
  - ii. first mortgage investments only
- commissioning or conducting independent valuations by registered valuers of the investment property as security
- advising clients of investment performance and rates of interest
- facilitating client redemptions in accordance with their offer to investors

The majority of legal firms which operate/have operated these schemes in Tasmania have rigidly abided/continue to abide by these rules.

Specifically in relation to Garrisons, solicitor firms generally provided the following on-going reporting:

- confirmation of initial placement of funds with first mortgage investments and any subsequent reinvestment;
- quarterly or six monthly interest statements confirming interest earned during the relevant period and the name of the borrower(s) where funds were invested;
- annual reconciliations showing total movement in the client's account during the financial year (including total interest earned for the year);
- collection fees charged by solicitor firms;
- when interest rates moved, a statement of advice was forwarded to Garrisons on behalf of investors.

Apart from interest rate movements and interest earned on clients' investments, there was no other performance reporting from solicitor firms. However, once it became apparent that some investments were in default, solicitor firms provided further reporting. This included updated reporting on each individual loan (such as the amount lent and the valuation of the property, status of any refinancing, status of any

impending sale, and status of any potential problems). It should be recognised that in many instances clients received this information direct from the legal firm/administrator and not via Garrisons as the legal firm(s) concerned chose to deal direct with the client.

### **ANY AGREEMENTS BETWEEN GARRISONS AND THE FOUR FUNDS IN QUESTION.**

There were no contractual or other agreements in place between any Garrisons advisor and any firm of solicitors regarding the mortgage products.

Unlike the majority of financial products used by advisors, the Solicitors Mortgage product did not provide either an upfront fee or an ongoing trail of income to the advisor. There were no direct or indirect remuneration outcomes for any Garrisons advisor using this product.

Mr Hudson did not directly or indirectly receive any remuneration from the legal practices for the use of their product. The products were used as part of an agreed financial plan with his clients.

### **COMMENT ON THE EVIDENCE PROVIDED BY THE LAW SOCIETY IN RELATION TO THE LEVEL OF RISK OF THE SOLICITORS' MORTGAGE SCHEME INVESTMENTS.**

The evidence provided by Mr Jackson (Hansard, p. 968) in relation to a question from Senator Sherry stated, "It might have been a reasonable expectation that they [solicitor mortgage schemes] were **secure** investments, but I do not accept that any investor who carefully considered the investment they were making would have come away with the view that their investments were guaranteed."

The evidence provided by Mr Creswell on behalf of Garrisons (Hansard, p. 1049) stated, "The Law Society this morning said they believed they were a capital **secure** investment. I think you [Acting Chair] may have even said the same thing. So I am a little confused on that question."

It is clear that the Law Society and Garrisons are of the opinion these investments would be viewed as being **secure**, as distinct from guaranteed. At no stage has Garrisons ever referred to these investments as guaranteed. Garrisons has always maintained that solicitor mortgage scheme investments are secure. They are secure because the underlying investment, being the mortgage, is required by Law to be secured by way of a registered first mortgage over real property. Further protection is afforded to investors in the event of a defalcation or breach of fiduciary duty by the solicitor whereby the Courts can invoke the Solicitors Guarantee Fund to compensate investors who suffer a loss as a result of such a breach.

In relation to the level of risk, we were unable to find in the Hansard any statement by the Law Society addressing this area of Solicitor First Mortgage investments. The Law Society only makes mention that these investments were secure. The main risks suffered by these types of investments are credit risk and liquidity risk. Garrisons view is that these investments, in an orderly market and when properly managed, are low risk, because they are secured by a registered first mortgage to

the value of 66% of the value of the property and have the added safeguard by way of the guarantee fund. Hence credit risk is minimised because in the event of a default there should be adequate security to protect the investors capital. In relation to liquidity risk, this has only been exacerbated because of the lack of market confidence and the time taken to realise property sales. Once again, in an orderly market, liquidity risk can be properly managed and this has proven to be the case in Tasmania for these types of investments over many decades.

**FIGURES ON THE AMOUNT OF INVESTORS' MONEY GARRISONS PLACED WITH EACH OF THE SOLICITORS MORTGAGE SCHEMES FIRMS IN QUESTION, INCLUDING TOTAL MONIES PLACED WITH ALL OF THE SCHEMES.**

Prior to December 1998 clients of Garrisons had invested around \$18 million via 13 different solicitor firms. **It should be noted that this figure is the total figure and includes amounts invested by clients directly (and not recommended by Garrisons) and investments by clients prior to seeking advice from Garrisons.** The firms used by clients of Garrisons were Piggott Wood & Baker (\$6m), Lewis Driscoll & Bull (\$3m), Ogilvie McKenna (\$3m), Ware & Partners (\$3m), Butler McIntyre & Butler (\$1m), Gunson Pickard & Hann (\$1m), McCulloch & McCulloch (\$0.6m), Henry Wherrett & Benjamin (\$0.25m), Hall & Thompson (\$0.2m), Page Seager (\$0.1m), Ogilvie Breheney & Ayliffe (\$0.05m), Clerk Walker & Stops (\$0.02m), Dobson Mitchell & Allport (\$0.02m). At the time, it was estimated that the entire market in Tasmania was around \$650 million. Therefore, Garrisons had clients who comprised around 2.9% of the entire investments that are believed to have been held in solicitors mortgage funds in Tasmania at the time.

In December 1998, as a result of the requirements of the Managed Investment Act, the failure of the firms managing these funds and because of other similar product opportunities that matched the clients needs, Garrisons recommended to its advisors that it should redeem client funds on an orderly basis from solicitors mortgage firms and seek to place these investments in other products suitable to the clients' needs.

By careful management Garrisons has effectively reduced its clients exposure to around \$2 million of problem loans. The vast majority of these clients are with one advisor, Mark Hudson. The balance of the advisors only have a very small number clients with investments in problem solicitors mortgages. Garrisons sought to remove all its clients from Tasmanian solicitor first mortgage products. It was not successful with a portion of those clients because:

- loans were already defaulting and could not be moved;
- clients did not wish to move their monies;
- press coverage and redemption requests around the time removed the liquidity of certain funds.

The \$2 million of problem loans is limited to Lewis Driscoll & Bull (around half of this amount) with the balance being with Piggott Wood & Baker, and Ware and Partners.

Any remaining investments, being less than 25% of the total capital invested by Garrisons clients, is invested with solicitors mortgage schemes on the basis that our clients have specifically requested to continue with the investment because they

have experienced no problems and achieved their desired financial outcomes or monies remain in defaulting mortgages where the underlying assets are yet to be realised or other recovery actions have not yet been completed.

## Appendix A

### THE ROLES & RESPONSIBILITIES OF PARTIES TO SOLICITORS MORTGAGE INVESTMENT SCHEMES

#### THE ROLE OF THE LEGAL FIRMS

The firms of solicitors were the promoters and the administrators of these schemes. Their responsibilities included:

- receiving investors monies either directly or through financial advisors
- fiduciary duties arising from holding monies on trust for investors
- placing those monies in investments under the guidelines required by their rules of practice, ie
  - i. up to 66% of security valuation
  - ii. first mortgage investments only
- commissioning or conducting independent valuations by registered valuers of the investment property as security
- advising clients of investment performance and rates of interest
- facilitating client redemptions in accordance with their offer to investors

The majority of legal firms which operate/have operated these schemes in Tasmania have rigidly abided/continue to abide by these rules.

There are some firms who either have not, or appear to have not, abided by the rules. These are the only firms that appear to have caused their clients potential loss.

The promoter of the solicitors mortgage products for these firms are clearly responsible for any losses or potential losses to investors in these schemes. Specific details on each firm which has experienced significant problems with defaulting loans are:

#### LEWIS DRISCOLL & BULL (LDB)

The Supreme Court of Tasmania appointed Mr Peter Worrall, to manage this firm on 11 December 1998. Mr. Worrall's responsibilities have included an examination of the status of the business and communication to clients with investments in the mortgage scheme operated by Lewis Driscoll & Bull.

Mr Worrall's role was and is primarily concerned with winding up the business and the mortgage scheme. It became clear to Mr Worrall that the mortgage scheme had not in a number of areas, complied with the required Rules of Practice.

The appointment of Mr Worrall was recommended by the Law Society

#### MCCULLOCH & MCCULLOCH (MM)

This practice was being run by Alistair and Quentin McCulloch. Late in 1998 some problems were discovered with the management of the mortgage practice of the business which was run by Alistair McCulloch on behalf of the practice. Alistair McCulloch was declared bankrupt and a manager was appointed to oversee the wind



up of the mortgage scheme. Peter Joyce of Butler MacIntyre and Butler was appointed to this role.

Investors in McCulloch and McCulloch are in the process of having their capital returned via an application to the Solicitors Guarantee Fund.

### **PIGGOTT WOOD & BAKER (PWB)**

In December 1998, which was around the time of the appointment of Mr. Worrall as administrator of Lewis Driscoll & Bull, the partners of Piggott Wood and Baker, one of the largest and more highly respected legal firms in Tasmania provided information to investors that indicated there were liquidity problems associated with their solicitors mortgage scheme and there were a number of defaulting loans. Various correspondence was sent to investors either directly from PWB or from Deloitte Touche Tohmatsu who were appointed by PWB to provide investors with status reports on their mortgage investments.

Subsequent to this, we have been informed that disciplinary action has been taken against two of the partners by the Law Society. This action was taken almost two years after the problems were reported. These time delays are difficult to understand. PWB are still attempting to manage their own fund where it appears clear that they have not previously been competent to do so.

### **THE ROLE OF THE LAW SOCIETY IN TASMANIA**

It is the responsibility of the Law Society to provide / recommend appropriate guidelines for its members on a range of matters including the operation of solicitors first mortgage schemes. The Law Society had fulfilled its obligations in respect of providing those guidelines to its members through the Legal Profession Act 1993.

In 1992, the Law Society submitted to the then ASC (now ASIC) representation that it believed that it could provide assurances that it was able to adequately monitor the control mechanisms afforded by the Rules of Practice to the extent that the Society should be exempt from complying with the Corporations Law.

The society further represented that "coupled with the supervisory and investigatory roles 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."

It is understood that the Rules of Practice required an account inspection of the solicitors Trust Accounts. The performance of such inspections were the responsibility of the Law Society. The scope and terms of reference were included as part of the Rules of Practice.

It appears that where these inspections have been conducted they have not discovered the underlying problems. This may have been as a result of either the scope of the examination not being adequate or the actual inspectorial actions not appropriately completed. Alternatively these underlying problems may have been reported to the Law Society and not subsequently enacted upon.

We are not in a position to ascertain the actual reasons but based upon the representations of the Law Society we think it is reasonable for any advisor to expect that the inspectorial examinations were being conducted and would detect any failures to comply with the Rules of Practice.

## **THE ROLE OF THE VALUERS**

It is our understanding that the Rules of Practice governing the operations of the Solicitors First Mortgage Schemes require a valuation to be conducted by a registered valuer to support the underlying investment. Since the failure of the funds, further information that was not previously available to us indicated that in several instances, these valuations are unable to be reasonably supported, the basis of the valuation has been flawed or indeed valuations were not completed prior to the establishment of the mortgage investment.

Clearly valuers who have not conducted appropriate independent valuations on a proper basis must bear liability. We understand a number of legal actions have already commenced against those valuers who have allegedly provided inadequate valuations. The role of the valuers, the processes they employed and the instructions they received required more thorough investigation. Garrisons does not have the legal capacity to do this but as part of its efforts on behalf of investors, has made inquiries and sought evidence to support questionable property valuations.

To our knowledge, no valuers have provided submissions to the Senate Select Committee, nor has any evidence been provided by the valuers responsible.

## **THE ROLE OF ACCOUNTANTS**

We are informed that a number of valuations were supported by projections provided by accountants of the borrowers. These projections were used to establish indicative value of property developments.

Further details have not been provided to us but it was not the understanding of Garrisons, its advisors or its clients that investment monies would be placed into property development schemes other than existing and established commercial or residential developments.

## **THE ROLE OF FINANCIAL ADVISORS**

A number of financial advisors in Hobart were using the Solicitors First Mortgage product as an investment option (along with other investment options) as part of fulfilling their client's financial needs.

Advisors clients had monies invested in solicitors mortgage schemes through the following mechanisms:

- Clients who already had the investments, were satisfied with the returns, were knowledgeable about the commercial risks and wished to retain these investments in solicitors mortgage schemes.

- Clients had specifically instructed their advisor to invest in these schemes for a variety of reasons including:
  - ◊ The attractive rate of interest
  - ◊ Their personal relationships with solicitors
  - ◊ The desire to have investments in Tasmania (this was one of very few opportunities available to them)
- Advisors who advised their clients to speak directly with the legal firms where they were inexperienced with the nature of these investments
- Advisors who recommended these products as part of an overall self managed fund for their client.
- Advisors who otherwise recommended these products as part of an overall financial plan designed to meet their client objectives.

Garrisons planners, who were based in the Hobart, had extensive experience with the operation of solicitors first mortgage schemes in Tasmania. These planners had clients with investments in a range of solicitor's funds.

The Garrisons advisors had clients with investments in 13 different legal practices in Tasmania, all of which were based in Hobart, the majority of which were household names in Tasmania and considered to be reputable legal firms.

## **THE ROLE OF THE FINANCIAL ADVISOR – MARK HUDSON**

Mark Hudson is an experienced and well-qualified advisor from the Hobart office of Garrisons. Mr Hudson is an authorised representative of Garrisons and has been since 1991.

Mr Hudson's qualifications include being a Certified Financial Planner, a Chartered Accountant and a registered Tax Agent. These formal qualifications would place Mr Hudson in the top 10% (in terms of qualifications) of most licensed dealers in securities in Australia and probably higher than that in Tasmania.

To maintain these qualifications and memberships of professional bodies, Mr Hudson has been required, on an annual basis, to undertake a range of structured and unstructured continuing education courses.

Mr Hudson has broad and relevant commercial and financial skills that have made him a planner sought by many clients to provide them with advice. Mr Hudson, with his chartered accounting and taxation experience, was in a position to advise many clients on their own 'self managed superannuation funds'.

Many of Mr Hudson's clients decided that they wished to operate a 'self managed superannuation fund' and as part of their overall financial plan, had investments through their self managed fund with solicitors mortgage products.

Once the financial plan and overall strategy was agreed with the client, Mr Hudson often sought to place the secure portion of the clients' investment with an appropriate solicitors mortgage product.

Because of the nature of his business and his extensive experience with self managed funds, Mr Hudson had knowledge of firms who had investment opportunities available through their mortgage product. Mr Hudson had experience in placing monies, ensuring interest was received and redeeming monies on behalf of his client for a number of years with little or no problems.

Mr Hudson was a significant contributor to the LDB fund but was not the only person placing monies in this fund. This fund was offering a good interest rate but only slightly above others and Mr Hudson's research and experiences had not encountered any particular problems with this fund. Details of Mr Hudson's specific and general research into solicitors mortgages is detailed as follows:

#### **General Research Conducted Included:**

- Personal investment and involvement in three SFMF (including prior to 1994)
- An understanding of the product;
- An understanding of the way the product was regulated, including perusing the Legal Practitioners Act; and the Rules of Practice regulated by the Law Society of Tasmania.
- An understanding of the history of the product and the associated risk factors;
- The use of registered valuers to obtain reliable valuations of real property in Tasmania.
- Reputation of the legal profession in Tasmania as a whole and the partners of the individual firms;
- The fact that the Law Society had a Fidelity Fund to cover any capital losses in the event of a breach by a practicing solicitor;
- The fact that property prices in Tasmania were and are very conservative and less volatile than other states.
- Available information through professional publications Information available in the general domain.
- Information available in the general domain

#### **Specific Research Conducted Included:**

- Due enquires of each legal firm to gain an understanding of their credibility, background, amount of funds managed, and how long the practice had been managing a SFMF;
- I only dealt with legal firms in southern Tasmania (with the exception of one legal firm which was specifically requested to be retained by the client) in which I had a reasonable business relationship with. This included an understanding of the way the practitioners operated and conducted their business, their reputation within the Tasmanian business community and the strength of their firm;
- Due enquiry as to the security of the investment, in the case of PWB, I was informed by Michael Burke that the partners guaranteed the interest in the event of a default and on at least 2 occasions was also informed that the partners guaranteed the principal in the event of a default. Letters of comfort were obtained from each practice which confirmed they continued to meet the requirements of the Law Society;

- I relied upon the fact that the Law Society regulated the funds and appointed an auditor to audit the funds to ensure my clients funds were invested in accordance with the Act;
- I also relied upon the fact that the software used in administering SFMF's was first approved by the Law Society and audited by a qualified auditor.
- For all SFMF recommended, I had a good business relationship with each partner and or representative and made regular enquiries of the funds. Such enquires included:
- Meetings with the partners and or representatives of the legal firms to question:
  - Time frame before forwarded funds could be invested
  - Time frame of accessibility
  - Borrower profile
  - History of Forced-sales
  - Plus all other specific research conducted including their track record etc.

## Appendix B

### ASIC INVESTIGATION OF MR HUDSON

On 21 May 1999, ASIC wrote to Garrisons requesting the provision of certain records through a Section 31 'Notice Requiring the Production of Books'.

The requested information was provided to ASIC.

On 7 June 1999, ASIC issued a further Section 31 notice requesting production of books and records in relation to 17 clients of Mr Hudson.

The requested information was provided to ASIC.

On 5 April 2000, some ten months after the requested information was provided to ASIC, Mark Hudson was issued with a Notice of Hearing under Corporation Law Section 837.

From the information provided to us, it appears that these investigative processes commenced, not as a result of any client initiative or complaint to the regulator by any client of Garrisons but rather a result of Mr Peter Worrall in his capacity as manager of Lewis Driscoll & Bull referring a matter he believed was of concern to him to ASIC.

We have been informed that ASIC wrote to clients of Mr Hudson inviting them to discuss matters with them and make a complaint to them regarding Mr Hudson.

A Hearing was held on Monday, 17 July 2000.

On 4 August 2000, ASIC announced the imposition of a conditional ban on Mark Hudson for a period of six months.

As part of this conditional banning order, it was noted:

"Mr Hudson may, however, continue to act as a representative of Garrisons Pty Ltd, a licensed dealer in securities, during the period of the ban on the condition that he:

- recommend only financial products approved by Garrisons Pty Ltd; and
- successfully completes a Graduate Diploma in Financial Planning offered by the Institute of Chartered Accountants."

Mr Hudson had the right to appeal ASIC's decision but declined.

From the nature of the banning order, it may appear that from an outside perspective, that ASIC were satisfied that Garrisons had proper compliance procedures in place to supervise the activities of its advisors.

Mr Hudson has completed his six-month conditional ban and has successfully completed the required training course. Mr Hudson continues to advise his clients from the Garrisons office alongside his fellow experienced advisors.