

CHAPTER 5

SOLICITORS' MORTGAGE SCHEMES IN TASMANIA

Background

What are solicitors' mortgage schemes?

5.1 Mortgage schemes have been operated by solicitors across Australia for over one hundred years. The funds in the schemes are usually administered by a solicitor who arranges loans in which real estate is offered as security. In some cases, the solicitor acts on behalf of a number of clients who each contribute funds to the mortgage. The services provided have been especially useful in rural areas where access to banks and other sources of funds was limited.

5.2 In Tasmania, the schemes were attractive to investors because investing with a legal firm was perceived to be a safe and prudent decision. Often the investors had close family ties with the practices concerned, either through shared community interests or because of family associations dating back two or three generations.

5.3 While there were some common features of the schemes, there were some differences in predicted returns as well as a fees and charges. **Appendix 3** gives some details of the fees charged by some firms of solicitors in Tasmania, and the conditions which applied to the investments.

Solicitors' mortgage schemes in Tasmania

5.4 In May 2001, 17 Tasmanian legal firms out of 150 were operating mortgage schemes. Of these, at least four firms have encountered difficulties with poor results for their investors.¹

5.5 Estimates of the number of investors negatively affected vary, although the evidence received by the Committee, consistently suggested that around 300 investors and up to \$20 million was involved.² In some cases retirement income streams have ceased, and repayment of principal or interest has not been forthcoming when requested.

5.6 The first indication that there were problems with a Tasmanian solicitor's mortgage fund occurred in late 1996. Following complaints, a Law Society trust account inspection of the firm of Macquarie Law managed by Mr Andrew Hurburgh, was undertaken following complaints to the Law Society about the management of the

1 The firms were Macquarie Law, Lewis Driscoll and Bull, McCulloch and McCulloch and Piggott Wood and Baker.

2 Submission No. 154, p. 1.

fund. Mr Hurburgh ceased to practise, relinquished his practising certificate, and a manager was appointed to the firm. A default order³ was obtained from the Supreme Court, and the investors in the fund ultimately recovered their capital – but no interest from the sale of the mortgaged properties and from payments from the Solicitors' Guarantee Fund.⁴ The Court declined to order the payment of interest because of the low level of funds in the Solicitors' Guarantee Fund which would have been insufficient to meet the amount claimed.

5.7 Between 1996 and 1998, three more mortgage schemes run by solicitors' firms were found to be in difficulties: Lewis Driscoll and Bull, McCulloch and McCulloch and Piggott Wood and Baker. Other firms experienced difficulties during this time, but these were not on the same scale as the three mentioned above.

5.8 The mortgage schemes had been heavily promoted and (at least initially) appeared to offer advantageous rates of return. However, in April 2001 it became clear that there were serious community concerns in Tasmania about the performance of mortgage funds administered by the three firms mentioned above.

5.9 The result has been that investors have lost considerable sums of money, which may or may not be recoverable. The investors, many of whom were elderly, had placed their retirement benefit in the mortgage schemes in the expectation of generating a steady retirement income.

5.10 Garrisons Financial & Retirement Specialists played a key role in referring clients to the schemes - particularly that operated by Piggott Wood and Baker. Of the estimated 300 investors affected by the demise of the schemes, 70 were Garrisons' clients.

5.11 In a submission to the Committee, Mr Arnold Sierink on behalf of a group of those affected by the schemes, outlined some of the difficulties in accurately estimating the extent of the losses. He pointed out that some victims were reluctant to come forward, due to acute embarrassment, shame and guilt. In some cases spouses were unaware that their partners had lost funds, and family members were unaware that other family members had done so. There was also a sense of having been betrayed by a person whom the investor trusted – often a long-standing family solicitor. Mr Sierink continued by advising the Committee that:

³ A default order is an order made by the Supreme Court on an application by the Law Society, or a person, a firm or a legal practitioner who claims to have suffered loss as a result of a fiduciary (financial) default by a solicitor.

⁴ The Solicitors' Guarantee Fund is established and operated by the Solicitors' Trust. The funds are raised through investment of funds from solicitors' trust accounts. The Solicitors' Guarantee Fund provides some operating funds for the Law Society, the Law Foundation and the Legal Ombudsman.

[The] 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 monies.⁵

In her submission to the inquiry, Ms Joycelyn Walsh, a retired dressmaker and retailer, now a single pensioner, told of her experiences with her ‘nest egg’ of \$65,000, and concluded:

I now have to think seriously about downgrading my home, because without my capital and interest I am finding it very difficult to manage the basic household expenses.⁶

5.12 While the public focus was largely on the losses experienced by investors, borrowers were also victims of the problems which occurred. The Tasmanian economy, buoyant at the beginning of the 1990s began to decline in the middle of the decade. The result was a decline in the property and building market, and a decline in the ability of borrowers to repay the funds advanced to them. In particular, when investors sought a refund of their money, in many cases, the borrower had no alternative but to sell the security (often in a depressed market) which may or may not have realised sufficient funds to discharge the mortgage. This had the potential to leave both the borrower and the lender with less than before the mortgage was negotiated.

5.13 A chronology of events concerning solicitors’ mortgage schemes in Tasmania for the period 1992 to 2001 appears at **Appendix 4**.

Issues

5.14 During the course of the inquiry a number of issues was identified which appeared to contribute to the problems experienced with solicitors’ mortgage schemes. These included:

- the effectiveness of the regulatory framework;
- the role and conduct of the Law Society of Tasmania, including its oversight of firms of solicitors, trust account inspection reports and procedures, and its oversight of, and response to client complaints;
- the appropriateness of valuation practices;
- the adequacy of the practices of financial advisers;
- access to consumer support mechanisms; and
- the impact of external economic factors on Tasmanian investments.

5 Submission No. 154, p.3.

6 Submission No. 132, p.2.

The regulatory framework

5.15 The adequacy of the regulatory framework was one of the most important issues raised during the inquiry. Solicitors' mortgage schemes in Tasmania are currently regulated by the Law Society of Tasmania. The Society operates under an exemption from the supervisory and regulatory requirements imposed under the Commonwealth's Corporations Law, which is administered by the Australian Securities and Investments Commission (ASIC). This exemption was granted initially in 1992 after an inquiry by the former Australian Securities Commission (ASC), and has been renewed periodically since.⁷

5.16 In granting the exemption, ASIC accepted the Law Society's assurances that the Society's regulation, control and supervision of solicitors' accounts would provide adequate protection and accountability to mortgagors and mortgagees alike.

5.17 In its submission to the regulator, the Law Society stated that the ASC 'may choose' to recommend that the Corporations Law should not apply to the legal profession because 'it is sufficiently controlled under state laws.'⁸ The Society contended that:

... its existing methods for the regulation, control and supervision of the accounts of solicitors which (inter alia) extend to the supervision of monies received for investment on mortgage; to their application; and to the maintenance and preservation of the securities taken, provides a desirably high measure of protection for all clients and investors.⁹

5.18 The submission also sought to assure the ASC that :

- the legal profession's service to mortgagors and mortgagees was of a high standard;
- there was a very low risk of non-compensated loss;
- the provisions for indemnification of clients for loss occasioned by negligence or fraud were a substantial assurance for members of the public, and a measure of security not available to the public in its dealings with other institutions.¹⁰

5.19 In addition to these assurances the undertaking included access to the Solicitors' Guarantee Fund to compensate investors who had lost funds through the fraudulent activity of lawyers.

7 Similar arrangements also applied in other States.

8 Submission No. 137, attachment 1, p. 2.

9 Submission No. 137, attachment 1, p. 2.

10 Submission No. 137, attachment 1, p. 2.

5.20 Solicitors' practices are also regulated under Tasmanian State legislation. This includes the *Legal Profession Act 1993*, which defines the parameters of legal practice, and the *Trustee Act 1898*, which imposes prudential obligations on the Trustee to, among other duties, obtain independent valuations on properties offered as security, and ensure the security of investments made.

5.21 In addition the Tasmanian *Valuers Registration Act 1974* provides for the registration and deregistration, as well as professional qualifications of valuers. It contains no provisions for the compensation of clients affected by poor valuation practices.

5.22 In Tasmania properties are registered with the Land Titles Office. Although not integral to this inquiry, the Committee notes that some concerns were expressed about the integrity of the records of the Tasmanian Land Titles Office.

5.23 Within this regulatory framework, witnesses drew attention to a number of deficiencies in the Law Society's performance of its regulatory duties. For example, in his evidence to the Committee, the Hon. Ray Groom, MHA, Shadow Minister for Justice, recounted his discussions with a group of investors who had approached him with their concerns. He said:

... people feel that the Law Society has failed to properly regulate the schemes ... [and to] ... act properly to supervise these investments.¹¹

5.24 In their submission Mr and Mrs Sierink stated that they:

... believe that if the criteria under which the Law Society of Tasmania obtained their exemption from the Corporations Law in 1992 had been adhered to, and if the Law Society had properly regulated and audited the Solicitors' First Mortgage Schemes together with proper research undertaken by Garrisons, the problems now being experienced would never have taken place.¹²

5.25 The Law Society's view was that its regulatory regime was approved by ASIC and its predecessor, the ASC, and the Society had discharged its functions within those rules. The President of the Society, Mr Philip Jackson, conceded that the rules may have been inadequate but emphasised that:

... those rules were approved by the ASC. If they did not perceive they were inadequate, why should the Law Society have been able to perceive they were inadequate?¹³

11 Committee Hansard, p. 955.

12 Submission No. 131, p. 3.

13 Committee Hansard, p. 975.

5.26 The Society also indicated that its powers of control over the Fund operators were not comprehensive and did not extend beyond what was contained in the Rules of Practice.

5.27 ASIC denied that the ASC approved the rules. In evidence to the Committee, Mr Ian Johnston, ASIC's Executive Director, Financial Services Regulation, said:

... the statements that were made by the various law societies going back into the early 1990s were of the nature that said they would have... sufficient resources to supervise these schemes. Some of them proffered rules which were not approved by ASIC or the ASC as it was then. It was not the case that the ASC approved the rules that they had but the rules were one of the things that were taken into account. ... [R]egulatory frameworks... would have been part of the submission that they made, and we would have approved the body to be the supervisor, ... that does not mean we approved the regime they have sitting underneath.¹⁴

5.28 ASIC indicated to the Committee that it agreed with the proposition that the undertakings given by the Law Society in 1992 in relation to the supervision of mortgage schemes did not appear to have been met.¹⁵ However, ASIC acknowledged that the industry had undergone considerable change since that time. ASIC further advised that as a result of the *Managed Investments Act 1998*,¹⁶ and its own investigation of mortgage schemes, the majority of fund regulation will be supervised by ASIC under a more rigorous regime, from 31 October 2001.

5.29 However, the Committee notes that the small funds with fewer than 20 members will not be covered by the new ASIC regulation. The Committee sought an assurance from the Law Society that it would develop appropriate procedures to deal with these funds in order to ensure that the investors in them are in no less a position than those in funds administered under ASIC's legislation.

5.30 In response to this request the Law Society advised that it had commenced discussions with ASIC and would consider the matter further.

The role and conduct of the Law Society of Tasmania

5.31 Related to the adequacy of the regulatory framework is the Law Society's role in the schemes, and the manner in which the Society conducted itself.

5.32 As part of its statutory duties, the Law Society has the following functions:

- the regulation, promotion and representation of the legal profession;

14 Committee Hansard, p.1146.

15 Committee Hansard, p.1143

16 All schemes must either be wound up or registered with ASIC by 31 October 2001. The date for compliance may be extended on application to ASIC before the due date of 31 October 2001. Extensions will be considered in limited circumstances with strict conditions.

- the promotion of law reform;
- any other functions which promote the objects of the Society.¹⁷

5.33 In addition, the Society may do all things necessary or convenient to perform its functions.

5.34 The *Rules of Practice 1994* prescribe the manner in which certain practice tasks are to be undertaken, including the maintenance and administration of trust accounts. The Rules also address the conduct of mortgage funds including prescribing the ratios of capital funds to borrowed funds.¹⁸

5.35 A number of investors expressed concern about the Society's statutory functions. For example, Mr Groom conveyed the view that had been expressed to him that the Law Society's dual roles of regulating and disciplining solicitors while promoting and protecting their image, involved an inherent conflict of interest.¹⁹

5.36 In addition to this apparent conflict of interest, a number of other issues about the Law Society were drawn to the Committee's attention including the adequacy of its oversight of firms, trust account inspection reports and procedures and its oversight of consumer complaints.

Law Society oversight of firms

5.37 As part of its role as defined by the Act and the Rules of Practice, the Society must oversight:

- practitioner registration, including ongoing education;
- compliance with ethics;
- supervision of trust accounts; and
- handling complaints about practitioners.

5.38 In evidence to the inquiry the management of some of the schemes was heavily criticised. For example, Mr Peter Kang-Scheit noted poor risk assessment by solicitors' firms as a major factor in the collapse of the mortgage funds.²⁰

17 Section 6(1) (a), (b), (c) and Section 6(2) of the *Legal Profession Act 1993*.

18 Part 5 of the *Rules of Practice 1994* addresses this area. Section 62 defines a first mortgage and then prescribes the lending ratios which apply. The amounts advanced must not exceed two-thirds of the security valuation if the mortgage is not insured. If the mortgage is insured, 90 per cent of the security valuation will be advanced. The insured amount is that part of the advance which is over two-thirds of the security valuation. If there is no security valuation, the amount advanced will be 50 per cent of the government valuation in force at the date of the mortgage.

19 Submission No. 130, p.5.

20 Submission No. 164, p.2.

5.39 Mr Patrick Toomey, a solicitor who has been instructed by a number of clients affected by the collapse of the mortgage schemes, pointed out that McCulloch and McCulloch lent funds without obtaining valuations, lent funds to a business partner (who was also the principal of the firm Lewis Driscoll and Bull) and lent funds on a series of inflated valuations.²¹

5.40 In relation to this point, Mr Peter Joyce, court-appointed manager of the McCulloch and McCulloch fund indicated in his submission to the inquiry, that the low quality of the security properties was reflected in the large number of mortgagee sales which resulted in a capital loss to the investors.²²

5.41 Mr Toomey also submitted that in the case of Piggott Wood and Baker, injudicious lending practices were undertaken in a number of cases.²³ These included apparently lending on high-risk mortgages on a number of properties, as well as relying on unreliable valuations.

5.42 Piggott Wood and Baker responded by stating that the properties were the subject of independent valuations. However Piggott Wood and Baker also advised that it had accepted that in at least one case there had been a negligently prepared valuation, and that sales of other properties had yet to be finalised.²⁴

5.43 In his submission to the inquiry, Mr Peter Worrall, court-appointed manager of Lewis Driscoll and Bull, indicated that the Lewis Driscoll and Bull fund was characterised by poor quality lending with little risk assessment, and no assessment of the capacity of the borrower to service the loan.²⁵

5.44 The Law Society's view was that its role was limited to assessment of fund management as evidenced by its trust account inspections, and by its management of complaints in accordance with the Rules of Practice. In evidence to the inquiry, Mr Philip Jackson stated that those rules were prepared for the Society and emphasised that the Society did not prepare them, 'although it formally made them in council'.²⁶

5.45 The issue of compensation to investors who have lost funds was also raised in evidence with the Law Society. The Solicitors' Guarantee Fund is a limited source of compensation for those clients of solicitors against whom a default order has been obtained. Where a default order has not been obtained, no compensation is available.

5.46 In canvassing possible additional sources of compensation the Society was asked by the Committee, if in the event of loss and, given the assurances that were

21 Submission No. 137, p.10.

22 Submission No. 160, p.2.

23 Submission No. 137, p.11.

24 Submission No. 176, p.9.

25 Submission No. 155, p.2.

26 Committee Hansard, p.968.

given to the ASC would the Society be prepared to levy its members. The Society's President responded:

The question is premature because there is no basis at the moment for supposing that there might even be any need to do that.²⁷

5.47 When pressed, the Society also did not concede that a general levy on practising solicitors would be appropriate, as many of the current practitioners would not have been in practice either when the undertaking was given to the ASC nor when the mortgage schemes began to go awry.

Law Society oversight of trust account inspection reports and procedures

5.48 The scrutiny of solicitors' trust accounts became a major issue of concern during the inquiry. In particular, concerns were expressed to the Committee about whether the trust account inspections revealed the true state of the trust accounts, and whether the trust account inspection provisions were sufficient to detect the practices which resulted in the collapse of the funds.

5.49 Section 17 of the *Legal Profession Act 1993* allows the Law Society's governing body (the Law Society Council) to make Rules of Practice for regulating a number of matters. The relevant matters for this inquiry are:

- the professional practice, conduct and discipline of barristers and legal practitioners and foreign lawyers;
- the establishment of accounts at authorised deposit-taking institutions for money of clients;
- the keeping, inspection and audit of records relating to money received, held or paid for on behalf of clients.²⁸

5.50 Part 3 of the *Rules of Practice 1994* deals with the maintenance, administration and inspection of trust accounts. It was a popular belief among investors that the solicitors' mortgage funds would be audited. Several submissions expressed concern at what they saw as the Law Society's neglect in this area.²⁹

5.51 Mr Leon Morrell, an investor in a solicitors' mortgage scheme advised the Committee that:

My understanding was that there was a twice-yearly monitoring-audit-of these funds. If there was twice yearly auditing, how come this has all happened?³⁰

27 Committee Hansard, p.966.

28 See Sections 17(1) (a), (d), and (e).

29 Submission Nos. 128,154,195.

30 Committee Hansard, p. 951.

5.52 The Society argued that its role in trust account supervision was limited to inspection only - not to auditing. The President of the Society, Mr Philip Jackson stated that:

There has never been any auditing process because the rules do not provide for it and the Society has no power to audit. The Society has a power to inspect. The Law Society, I should emphasise, did not prepare those rules, although it formally made them in council, and they were in fact approved by the ASC. They provide for inspections only and those inspections have been carried out from year to year.³¹

5.53 In his submission, Mr Patrick Toomey pointed out that the Council did have the power to provide for auditing rather than inspecting documents under section 17(1) (e) of the *Legal Profession Act 1993*. He continued:

Any defect in a Scheme which would have been uncovered by an audit and not by the inspection results from the Society's voluntary circumscription of its own powers.³²

5.54 Mr Toomey took the view that a properly conducted audit would have revealed the extent of the breaches of trust occurring within certain schemes including the lack of compliance with prudential requirements, the conflicts of interest and the taking of unauthorised commissions and the lack of independent valuations.

5.55 The Society described Mr Toomey's views as 'arrant nonsense' and continued:

Whether an examination of books of account is described as an inspection or an audit, such an examination by its very nature can be no more than an examination of a sample of records, not an entirety of records.³³

5.56 In support of this, the Society cited the case of one of the firms now under management, and indicated that a trust account inspection report concluded that the records were well maintained, and 'particular care and attention [was] given to the mortgage fund.' While the inspector expressed concern about the spread of some loans, he concluded that the Society had no control over this issue, and the solicitor was complying with the Rules of Practice. In the Society's view, this example highlighted the inaccuracy of Mr Toomey's view, rather than the fact that the Rules of Practice themselves were inadequate as a supervisory tool.

5.57 According to the Law Society, its contracting resources also affected the manner in which trust accounts (and therefore the mortgage schemes) were inspected. Mr Timothy Bugg, former President of the Society also indicated that in 1998 the

31 Committee Hansard, p. 968.

32 Submission No.137, p.7.

33 Submission No. 208, p.3.

Society decided to change the system of inspection from in-house to an outsourced system. When asked why this was, Mr Bugg replied:

[The in-house inspector's] term with the Society was coming to an end but the society could not, in that period, afford to employ someone else. In fact, during the term of [my] presidency a number of steps were taken to reduce staff because of resource issues brought on by lack of funds from the guarantee fund.³⁴

5.58 Further evidence by Mr Bugg indicated that he could not recall informing the ASC of the Society's decision about its inspection arrangements, nor the fact that the Society's resources were so depleted as to require changes in its supervisory regime.³⁵

Law Society oversight of client complaints

5.59 Evidence to the inquiry highlighted that one of the major complaints about the Society was the way in which it oversighted and responded to consumer complaints. Complaints ranged from delays in responding, to lack of response within a reasonable period or no response at all.³⁶

5.60 The Legal Ombudsman, Ms Judith Paxton, pointed out in her evidence to the inquiry that she had advised the Tasmanian Attorney-General of her concerns about delays by the Society in dealing with complaints and disciplinary matters. She acknowledged the resource issues facing the Law Society, but expressed concern at the need for an overall improvement in the handling of these issues.³⁷

5.61 The Law Society acknowledged that until late last year there were some problems with complaint resolution. Mr Philip Jackson, Law Society President, said in evidence:

We went to a great deal of trouble in the last half of last year to put in place a very comprehensive system to replace the existing system for dealing with complaints.³⁸

5.62 In order to free up resources to improve its complaint resolution system, Mr Jackson said that the Society had forgone any income from the Solicitors' Guarantee Fund for 1998 and 1999, substantially reduced staff levels, and reduced

34 Committee Hansard, p.972.

35 Committee Hansard, p.972.

36 Submission Nos. 129, 158, 164,169,181,190,234.

37 Submission No. 234, pp.3-4.

38 Committee Hansard, p.981.

member services.³⁹ It was also currently selling its premises to raise funds for its ongoing operations.⁴⁰

5.63 The Society expressed confidence in its revised method for dealing with complaints and indicated that it was now working well.⁴¹

Valuers and valuations

5.64 The valuations upon which the funds were advanced were also a significant issue for the inquiry.⁴² The Committee was advised that in many cases the valuations relied upon bore little relationship to the real value of the property. In evidence to the Committee, Mr Ian Johnston, Executive Director, Financial Regulation, ASIC, said that in a number of jurisdictions mortgage funds were characterised by poor assessment of borrower criteria and poor valuation practice.⁴³

5.65 In her submission to the inquiry, Mrs Cherylyn Harris, an investor with a solicitors' mortgage scheme, told of her increasing unease about the authenticity of the valuation of her investment.⁴⁴ One property increased in valuation by \$70,000 in five months. On contacting the valuer she was told that the borrower wanted to lease or sell the centre to someone to whom he owed money, and the increased sale price would allow him to pay the debt, as well as achieve his sale price.

5.66 In evidence, Mr Patrick Toomey, solicitor pointed out that he was also a registered valuer, and in his view the simplistic nature of the Rules of Practice, and the prescribed lending practices did not accommodate the commercial nature of the projects on which the funds were lent.⁴⁵

5.67 The Law Society indicated that the legal firms were dependent on the valuations they obtained from valuers to determine whether or not they were within their lending margins as prescribed by the rules.⁴⁶

5.68 Under the provisions of the Valuers Registration Act, the Valuers Registration Board in Tasmania registers valuers and has some regulatory function over them. In its submission to the Committee Mr Lou Rae, the Chairman of the Valuers' Registration Board, indicated since the Board's establishment, no valuer has been

39 Committee Hansard, p 968.

40 Committee Hansard, p 1211.

41 Committee Hansard, p 981.

42 Submission Nos. 133,164.

43 Committee Hansard, p.1142

44 Submission No. 129, p.4.

45 Committee Hansard, p.1001.

46 Committee Hansard, p.986.

fined or suspended, and at best, penalties have included admonitions, or mild rebukes. Further, the Board has no compensatory function for aggrieved consumers.⁴⁷

5.69 Mr Rae also indicated that, while there had been no complaints about valuers in respect of solicitors' mortgage schemes prior to the Committee's public hearing in Hobart on 18 May 2001, the Board had since received two complaints about a valuer involved with the mortgage funds. Mr Rae further indicated that while the Board could not determine these complaints, the parties have been invited to particularise them, so that the Board can inquire into the matter under the Valuers' Registration Act.

5.70 In addition, Mr Rae advised the Committee that the Board is to be abolished because of the limitations on its power to provide compensation to consumers, and to deal adequately with complaints. The proposed new legislation will prescribe a code of ethics and a more adequate complaints mechanism to be administered by the Tasmanian Director of Fair Trading.⁴⁸

5.71 In addition to being registered, most valuers belong to the Australian Property Institute. The Institute is a professional body providing, among other member services, admission, education, regulation, and setting professional practice standards. Mr Paul Wilson, Tasmanian Divisional President of the Institute, indicated in his submission, that there had been only one written complaint from one practitioner about another concerning perceived unethical business practices. The complaint resulted in a fine.⁴⁹

5.72 In evidence to the inquiry witnesses drew attention to the need for valuations to be obtained on behalf of both the mortgagor and the mortgagee to ensure that the interests of both parties were better protected should the property need to be sold. One submission also suggested obtaining regular valuations over the life of the mortgage of commercial property.⁵⁰

Practices of financial advisers

5.73 In evidence to the Committee witnesses drew attention to what they perceived to be poor practice by financial advisers such as Garrisons Financial & Retirement Specialists.⁵¹ This included a failure to research and evaluate the solicitors' mortgage funds prior to recommending them as part of a portfolio.

47 Submission No. 200, pp. 3 and 4.

48 Submission No. 200, p.5.

49 Submission No. 199, p.4.

50 Submission No. 140, p.5.

51 Garrisons is a 100 per cent owned subsidiary of Challenger International, and licensed dealer in securities.

5.74 Mr Arnold and Mrs Maureen Sierink were among the 70 investors affected by the mortgage schemes through their link with Garrisons. They shared the concern that Garrisons did not undertake sufficient research into the funds before recommending them as part of the portfolio and believed Garrisons were unwilling to assist them in recovering their funds.⁵²

5.75 In its submission to the Committee, Garrisons indicated that they believed solicitors' mortgage funds to be a 'proven conservative investment of long standing.' The firm indicated that they had relied upon the Law Society's lending rules, and its audit and supervisory provisions.⁵³

5.76 Garrisons advised the Committee that it had suggested solicitors' mortgage schemes to clients as part of an overall portfolio. They placed the funds with various mortgage schemes over a period of time. Details of the total amount invested with each firm by Garrisons in the period 1989-1998 appears at **Appendix 5**. Details of the annual amounts invested over the same period appears at **Appendix 6**.

5.77 The data show that Garrisons placed in excess of \$19 million into solicitors' mortgage schemes over a period of nine years, with the bulk of those funds invested between 1994 and 1997. Of the six funds into which Garrisons directed most of their investors' money, two have since been placed in the hands of managers, and one has serious difficulties. Furthermore the injection of money from Garrison's clients significantly increased the pool of investment funds available to these firms, In some cases it quadrupled the amount available in the fund over the four year period.

5.78 The fees charged by the solicitors administering the schemes varied between 0.4 per cent and 1.5 per cent per annum.⁵⁴ These were paid to the solicitors by those who invested directly in the schemes. For those who invested through Garrisons, Garrisons also charged their clients a percentage of the investment being made in addition to the fees levied by the solicitors. The effect was that Garrisons' investors paid a direct fee to Garrisons as well as indirect fees to solicitors.

5.79 In evidence to the Committee, Mr Michael Spinks, Executive Director of Garrisons, acknowledged that the firm was only able to indicate the net return to investors, and that it had no detailed knowledge of the fees and charges made by the solicitors in managing their schemes.

5.80 Prospectuses were not required to be provided by the solicitors' mortgage schemes but they were required for other mortgage investment schemes regulated by ASIC. Garrisons advised that they relied on the material issued by the solicitors, copies of which were provided to Garrisons. Garrisons did not necessarily prepare their own material on the schemes.

52 Submission No. 131, p.2.

53 Submission No. 152, p.1.

54 See Appendix 3.

5.81 ASIC acknowledged in evidence to the Committee that Garrisons should have had some knowledge of the underlying investments in solicitors' mortgage funds, but the level of detail was a 'moot question'.⁵⁵

5.82 The Committee was told that one of the Garrisons advisers had been subject to a six month banning order by ASIC in relation to his involvement in recommending the Piggott Wood and Baker scheme to clients of Garrisons. Mr Phil Creswell, Garrisons' National Audit and Compliance Manager and Company Secretary, explained that the order resulted from a determination by ASIC that their adviser did not know the mortgage scheme product as well as he should have.⁵⁶

5.83 The Committee was pleased to note that in one of the most significant positive outcomes of the inquiry, ASIC negotiated a rescue plan with Garrisons for their investors. Under the plan, Garrisons have undertaken to repay capital upon receipt of a signed deed and to pay interest of 6 per cent per annum to the estimated 70 clients who lost money through their referrals. The interest will be paid on or before 31 December 2002.

Access to consumer support mechanisms

Law Society- consumer assistance

5.84 Another significant issue raised during the inquiry was the lack of consumer assistance. Complaints were made about the length of time the Law Society took to respond to correspondence, and the Society's overall response to consumer problems.⁵⁷ Mr Charles Phillips, an investor, described the Society as an 'integral part of the problem rather than a help with any solution'.⁵⁸

5.85 Mr Jackson, President of the Law Society, expressed the view that the Society had gone to a great deal of trouble in the last half of last year to put in place a very comprehensive system to replace the existing system for dealing with complaints. According to Mr Jackson:

It works exceedingly well at relatively little cost now to the Society, with the enormous cooperation of the profession.⁵⁹

5.86 While the system may be working well for the Society, the information proffered by the witnesses and in the submissions was quite different. After investigation of a complaint, some clients were told by the Society that they should seek further legal advice. The cost of doing this merely added to their problems, and

55 Committee Hansard, p.1145.

56 Committee Hansard, p.1008.

57 Submissions No. 125,130,158.

58 Submission No.169, p.3.

59 Committee Hansard, p.981.

they noted that legal aid in Tasmania was, and continues to be generally unavailable for civil litigation.

5.87 The Society had a limited view as to the extent to which it was able to provide protection for consumers. The Committee was told by Mr Jackson:

I do not agree that we have a consumer protection role. We never have had. It may be that that is a desirable thing, provided we had the resources to do it. But our role is confined to ensuring that solicitors deal properly with their trust accounts and money that goes through their trust accounts. That is the beginning and the end of it.⁶⁰

Access to the Legal Ombudsman

5.88 One avenue pursued by some clients was the lodgment of complaints about the handling of their matters by the Law Society with the Legal Ombudsman. The duties of the Legal Ombudsman's position are set out in Part 4 Division 3 of the *Legal Profession Act 1993*. Under the Act the responsibilities of the position are:

- to monitor written complaints and applications lodged under this Part; and
- to investigate and examine any complaints made by any person in respect of the manner in which an investigation or hearing under this Part has been dealt with; and
- to investigate any other matter relating to disciplinary proceedings under this Part as the Attorney-General may direct.⁶¹

5.89 The Legal Ombudsman's position is part-time (about 12 hours per week). The Government provides office space, but there is no secretarial or administrative support.

5.90 Whilst the investors who sought the assistance of the Legal Ombudsman were generally positive in their comments about her approach to dealing with their complaints, it appears that the Ombudsman was limited in what she could achieve on their behalf.

5.91 In her evidence to the inquiry, the Legal Ombudsman, Ms Judith Paxton indicated that her powers of investigation were limited in that they did not relate to the complaints themselves, only the manner in which they were investigated. She also indicated to the inquiry that she had expressed concerns to the Attorney-General about both the length of time it was taking for the investigations of the complaints to be finalised; and the length of time that it was taking for any prosecution action to be completed.⁶²

60 Committee Hansard, p.987.

61 Section 85 (1) (a),(b),(c).

62 Committee Hansard, p.1238.

5.92 In her evidence, Ms Paxton said:

People would write to me or ring me and say that they were upset that they could not get information about their complaint—which they had lodged however many months before—from either the Law Society or Piggott Wood and Baker or McCulloch, as the case might be⁶³

5.93 Mr Groom observed in his evidence that the Legal Ombudsman:

... sees her role as being more limited than might appear on the face of [what is set out in the Act]—that she is there to oversee the complaints processes and disciplinary processes and to make sure that they are in order as she would see it as an independent person. But to investigate matters herself, to look into issues in detail, is probably beyond the power she has in some respects and also beyond the resources.⁶⁴

Freedom of Information

5.94 In their efforts to obtain information from the Law Society about the Solicitors' Guarantee Fund, some clients made application under the *Tasmanian Freedom of Information Act 1991* (FOI). For example, Mr Sierink indicated that he had tried to obtain from the Society, a legal opinion it had obtained from their counsel which set out the circumstances under which a person would have a right to a claim under the Solicitors' Guarantee Fund. He was unsuccessful in obtaining this advice and sought recourse through an application under FOI. The Society took the view that it was not subject to FOI legislation and refused access to the documents.⁶⁵

5.95 Under the *Tasmanian Freedom of Information Act* the State Ombudsman is responsible for reviewing decisions about access to documents under FOI. However, despite being able to review the decision, Mr Tony Allingham, Senior Investigation Officer from the Office of the Tasmanian Ombudsman, indicated in evidence to the Committee, that the Ombudsman had no ability to enforce a decision regarding access to documents under FOI, and in the case of a disagreement, the only recourse would be to take the matter to the Supreme Court.⁶⁶ This would depend on the person's capacity to pay for the litigation, and so a stalemate resulted.

5.96 The Society maintained that it was not subject to the *Tasmanian FOI* legislation, and this view was based on counsel's advice. Even if it were required to comply, the Society took the view that the information sought was subject to legal professional privilege, and would be exempt.⁶⁷

63 Committee Hansard, p.1240.

64 Committee Hansard, p.938.

65 Submission No. 184, p.2.

66 Committee Hansard, pp.1042-1043.

67 Submission No 151, p.3.

5.97 The Committee notes that at the end of June 2001 amendments to the Legal Profession Act and the FOI Act were introduced into the Tasmanian Parliament. It is the intent of these amendments that the Law Society will be subject to FOI legislation for the purposes of Parts 8 and 9 of the Legal Profession Act (the disciplinary and monetary protection provisions). The effect of this is that where a client seeks information from the Society regarding its investigations, information held by the Society will be obtainable under FOI.

Access to compensation and financial assistance

5.98 The investors have a number of options for recourse against the solicitors who have mishandled their investments. One option is civil litigation, an option which some investors have taken. Another alternative is to make an application for payment from the Solicitors' Guarantee Fund.

5.99 The Solicitors' Guarantee Fund is a mechanism by which those affected by the fiduciary default of a solicitor can recover their capital but may not receive interest on it. Recovery of the funds depends upon a default order being obtained from the Supreme Court. Whilst anyone affected can apply for an order, the cost involved can be considerable, and beyond the means of individuals. As previously mentioned, legal aid is not available for civil matters.

5.100 In May 2001 payments from the Guarantee Fund to investors in solicitors' mortgage schemes had reached \$10.8 million. The payments were made in respect of the Macquarie Law fund (\$9.2 million) and McCulloch and McCulloch fund (\$1.665 million). The Law Society indicated that there is a further \$1.5 million to be paid shortly to the McCulloch and McCulloch investors, with \$1.2 million owing, part of which is the subject of litigation.⁶⁸ The amounts paid are capital only - no interest. No payments have been made in respect of the Lewis Driscoll and Bull Fund, nor the Piggott Wood and Baker fund.

5.101 The Piggott Wood and Baker fund appears to be the largest fund still operating, with considerable numbers of investors who are waiting for the return of their funds. Some of these will be assisted by the package put together by Garrisons, as the Piggott Wood and Baker fund was the fund in which many of Garrisons clients invested. The remaining investors at present must rely upon sales of mortgage properties, refinancing or civil action. The Committee is somewhat constrained from commenting further about Piggott Wood and Baker, as there are presently matters still before the courts involving that firm.

5.102 The Committee understands that the Tasmanian Attorney-General is currently working with the Law Society to ensure that the fund is maintained at a level adequate to meet the number of potential claims.

5.103 Another avenue for emergency financial support for investors was seeking access to benefits from Centrelink. Witnesses drew the Committee's attention to their perception that Centrelink narrowly construed its deeming provisions under the Social Security Act, and included non-performing assets in its assessment of an individual's eligibility for benefits. However, in response to these concerns, Mr Bernard Harrington, Retirement Manager, Centrelink clarified Centrelink's position by indicating that his agency would provide part pensions on a case by case basis. He told the Committee:

... no-one in genuine hardship is refused assistance from Centrelink at all. The same rules apply to all investments, whether people have money in questionable solicitors' accounts or other sorts of accounts. ... We look at their individual investments, their individual circumstances and their need for ongoing income support under the income and asset test.⁶⁹

5.104 Mr Harrington also indicated that Centrelink operates a financial information service which helps people understand their investments, outlines options and provides an educative function for clients.

The impact of external economic factors

5.105 The Committee was advised that in addition to the problems regarding the regulatory framework, the conduct of the Law Society, and the conduct of some valuers and financial advisers, as well as inadequate access to consumer support, a number of external economic factors might also have contributed to the collapse of some solicitors' mortgage schemes. The Committee was advised that these included the market in which the mortgage funds operated; the structural changes in the lending industry; the deregulation of the banks which created unprecedented competition for the home lending market; and the mortgage funds' move from domestic to commercial lending.

5.106 According to Garrisons, for solicitors' mortgage funds, this resulted in a move away from lower risk lending to higher risk lending.⁷⁰ This is clearly substantiated by many of the submissions which reported that their funds were invested in commercial and development projects.⁷¹

5.107 The Law Society also identified a general downturn in the Tasmanian economy as contributing to the funds' decline.⁷² According to the Law Society this affected the borrowers' ability to repay the loans as well as the value of the property secured. As an example, in relation to its own property, the Law Society advised that

69 Committee Hansard, p.1257.

70 Submission No. 202 p. 10.

71 For example, Submission Nos. 114, 128, 137,155, 159, 164, 169.

72 Submission No. 150, p. 27.

it was finalising the sale of its head office which was purchased for \$1.3 million in the early 1990s, and sold for \$550,000 in 2001.⁷³

5.108 Mr Johnston, ASIC, lent some support to this view. He indicated in his evidence that there had been some decline in property values in Tasmania, which in combination with speculative lending had contributed to the problems with some of the schemes.⁷⁴

5.109 However, this view was not universal. Mr Toomey noted in his evidence:

There has not been a significant fall in the commercial market, which would knock out two thirds of valuation in the time scale we are looking at. The properties that have suffered the massive falls are where they were inappropriate to lend on in the beginning...They had on the face of them valuations that were patently incorrect to anyone and in other instances there were no valuations.⁷⁵

Developments during the inquiry

5.110 The Committee is pleased to report that as a result of its initiating this inquiry there have been a number of positive outcomes. As previously mentioned, one of the most significant is the rescue plan, negotiated by ASIC, being implemented by Garrisons Financial Advisers. Garrisons have undertaken to repay capital upon receipt of a signed deed and to pay interest of 6 per cent per annum to clients who have lost money through their referrals. The interest will be paid on or before 31 December 2002.

5.111 In addition other initiatives at the Commonwealth level include the following:

- Centrelink clarified that investors who have lost money through failed schemes can apply for social security assistance where pensions are affected.
- Legislative change has now been implemented which may assist in the prevention of similar problems with solicitors' mortgage schemes. The complete implementation of the Commonwealth Managed Investments Act from October 2001 will bring most schemes under the regulation of ASIC.
- ASIC has commenced a national review of solicitors' mortgage schemes, including a major inquiry into 'run out' practices. These are the funds which have not elected to move to the Managed Investments Act regime, and which must be wound up by 31 October 2001.
- As part of its national review, ASIC has also taken a number of other initiatives including:

73 Committee Hansard, p. 1211.

74 Committee Hansard, p.1142.

75 Committee Hansard, p.1001.

- instigating criminal action against a former solicitor Mr Thomas Baron, and Mr Haydn Dodge in connection with the solicitors' mortgage investment fund operated by the legal firm, Lewis Driscoll and Bull;
- applying to wind up a number of mortgage schemes;
- negotiating compensation for some investors;
- requiring additional licence conditions for responsible entities; and
- removing responsible entities from operating schemes.⁷⁶

5.112 At the State level, other outcomes to date in relation to solicitors' mortgage schemes in Tasmania include:

- The Tasmanian Valuers Registration Board and the Tasmanian Division of the Australian Property Institute clarified that investors can lodge complaints about valuers where losses have been incurred as a result of inflated property valuations; and
- Changes have also been made to the Tasmanian Legal Profession Act and Freedom of Information Act. These changes commenced on 16 July 2001. These amendments bring the Law Society into the FOI framework where clients seek information regarding legal practices, particularly concerning applications regarding solicitors' disciplinary matters. The amendments also reinforce trustee responsibilities for solicitor trustees by strengthening the penalty regime in relation to breaches of trust.
- On 21 August 2001 the Tasmanian Attorney-General introduced a further amendment clarifying the amendments of the 16 July 2001. This will ensure that the amendments operate retrospectively, and in particular, that the amendments relating to fiduciary default refer to losses suffered after 1 July 1995.

5.113 The Committee is also pleased to note, following discussions with the Tasmanian Attorney-General and others, that it is likely that the majority of the funds will be recovered over time. However, the Committee is concerned to ensure that all participants have access to financial recompense, not only those who have had the benefit of a formal default order through the courts or who have gained compensation through an arrangement with Garrisons.

Conclusions and recommendations

5.114 The Committee is concerned to note that the mortgage schemes as operated by some solicitors had a significant adverse effect on the investing community of Tasmania. The profile of that community mainly includes elderly retirees whose main

76 ASIC 2001 media and information releases 01/277, "Solicitors' mortgage scheme update".

or only investment to generate an income in retirement was the investment they made in a solicitor's mortgage scheme.

5.115 The Committee concludes that much of the financial and emotional distress caused by the failure of some prominent solicitors' mortgage schemes could have been alleviated had there been a more effective regulatory framework, and improved access to consumer information and support.

5.116 The Committee notes that the issues raised in its inquiry into solicitors' mortgage schemes in Tasmania are not unique to that State. There have been problems in other states with mortgage schemes administered both by solicitors and also by finance brokers. However, the Tasmanian experience has distilled the issues because of the effects on a small but discrete community.

5.117 Nationally, Western Australia and Queensland have experienced difficulties with mortgage brokers. Queensland, NSW and to a lesser extent, Victoria have also experienced difficulties with solicitors' mortgage schemes. ASIC has estimated that notwithstanding there are differing definitions of what constitutes default, there are over \$370 million of runout loans in default across Australia.⁷⁷

5.118 Subsequent to the Committee taking evidence on solicitors' mortgage schemes in Tasmania, the Committee has been provided with the outcome of the responses received following a discussion of solicitors' mortgage schemes on the Channel 9 *Money* program. This material confirms the extent and nature of the problems being experienced by people in all parts of Australia.

Regulation of solicitor's mortgage schemes- Commonwealth

5.119 Notwithstanding the class exemption granted to the Law Society, in the Committee's view, ASIC as the Commonwealth regulator, was ultimately responsible for the oversight of the regulation of solicitors' mortgage schemes. Although, under the class exemption that role was handed over to the Law Society, ASIC had approved the Society as the regulator. ASIC accepted the Law Society's assurances that its regulation, control and supervision of solicitors' accounts would provide adequate protection and accountability to mortgagors and mortgagees alike.

5.120 The Committee considers that ASIC could have played a more proactive role in overseeing the Law Society's regulation of the schemes. This may have included applying a more appropriate and rigorous review process when repeatedly granting exemptions to the Law Society.

5.121 The Committee is also concerned to note that while these problems occurred in the mid-1990s, ASIC appears to have been either unaware of, or chose to ignore what was happening. It took until February 2001 for ASIC to commence a

77 ASIC 2001 media and information releases 01/277, "Solicitors' mortgage scheme update".

concentrated investigation into the solicitors' mortgage schemes, by which time even more losses had been sustained. The Committee considers that more timely intervention or action by the regulator and the application of more rigorous review processes when granting the exemptions, could have mitigated the resultant losses endured by the investors.

5.122 The Committee acknowledges the work which has been done by ASIC since that time, including identifying strategies and initiatives for the ongoing regulation of the schemes. ASIC has advised that these strategies will:

- focus on the need for truly independent valuations to underpin mortgage security values;
- impose more specific lender conduct guidelines, particularly in respect of borrower's credit assessment;
- introduce more specific disclosure and reporting requirements; and
- query the public policy merits of permitting mortgage broking businesses to operate under the guise of a legal practice.

5.123 In relation to the last matter, the Committee particularly welcomes ASIC'S intention to examine the nature of the mortgage broking businesses, and expects this will also include considering the issue of whether lawyers are sufficiently qualified to undertake this work.

5.124 The Committee notes that the regime proposed under the *Managed Investments Act 1998* for the regulation of the majority of mortgage schemes, (including those operated by solicitors) will be more rigorous. The Committee expects that this will to a large extent alleviate many of the problems associated with the regulation of solicitors' mortgage schemes.

5.125 In the meantime, the Committee considers that with ASIC assuming responsibility for the regulation of most solicitors' mortgage schemes from October 2001 it would be appropriate for ASIC to work with the Tasmanian Government and the Law Society to devise strategies in relation to those funds with fewer than 20 members which will fall outside ASIC's supervision. This will ensure that those funds still enjoy benefits of a robust regulatory framework.

5.126 The Committee also notes that there are currently two funds, Lewis Driscoll and Bull and McCulloch and McCulloch being administered by court-appointed managers. Under the present arrangements, the costs associated with the management of the practices are paid by the Solicitors' Guarantee Fund.

5.127 The Committee is concerned that once ASIC takes over managed funds in October it is possible that they may replace the current court-appointed managers with receivers. In the view of the Committee this is undesirable because replacement managers will take some time to become familiar with the matters being handled, and because costs of receivers will be met from the sale of fund assets, not the Solicitors'

Guarantee Fund. The Committee considers that it is imperative to ensure that the investors' funds are not depleted unnecessarily.

Recommendations

5.128 The Committee recommends that ASIC work with both the Tasmanian Government and the Law Society to devise strategies for the ongoing management of McCulloch and McCulloch and Lewis Driscoll and Bull to the benefit of the clients awaiting compensation.

5.129 The Committee recommends that ASIC work with State governments and relevant law societies to ensure that appropriate strategies are developed for the supervision of mortgage investment funds with fewer than 20 members which will continue after 31 October 2001.

Regulation of solicitors' mortgage schemes - State

5.130 The Committee notes that a number of problems in the regulation of solicitors' mortgage schemes which were drawn to its attention during the inquiry pertained to perceived deficiencies in State legislation. These include deficiencies in:

- the *Legal Profession Act 1993* and *Rules of Practice 1994*;
- The *Trustee Act 1898*;
- The *Freedom of Information Act 1991*; and
- The *Valuers Registration Act 1974*.

5.131 As noted above, the Tasmanian Government has made amendments to the legislation applying to the legal profession, (particularly where solicitors act as a trustee) and freedom of information, which are designed to rectify some of the problems. The Committee commends the Tasmanian Government for its prompt action in introducing these amendments at this time. Those amendments are to be made retrospective, and in the case of fiduciary default, the amendment is retrospective to 1 July 1995.

5.132 However the Committee considers that there is scope for an even broader review of the State legislative framework pertaining to the regulation of solicitors' mortgage schemes. This might include a review of disciplinary procedures and penalties for solicitors who have been found to have engaged in professional misconduct. Such a review may assist to restore public trust and confidence in solicitors generally as well as other professionals associated with the schemes.

5.133 The Committee also notes that in relation to the Solicitors' Guarantee Fund, the Tasmanian Attorney-General is also currently working with the Law Society to ensure that the fund is maintained at a level adequate to meet the number of potential claims.

5.134 Further, the Committee believes that the level of funds in the Solicitors' Guarantee Fund should not be the basis for the amount of compensation awarded. In the view of the Committee the level of compensation should be set as return of capital plus interest at a specified rate – for example, the rate of interest applying to civil judgments in the Supreme Court.

Regulation of solicitors' mortgage schemes - the Law Society

5.135 The Committee's view is that, while there were other factors which contributed to the failure of some solicitors' mortgage schemes in Tasmania, the Law Society of Tasmania was dilatory in its response to the problems, and in its willingness to take positive action to address them. In particular, the Society:

- failed to regulate mortgage schemes adequately according to their undertaking to ASIC;
- took a narrow and inward looking view of its responsibilities;
- was unable to deal with complaints and problems efficiently and promptly;
- gave the appearance of protecting recalcitrant lawyers in dealing with complaints about solicitors mortgage schemes; and
- failed to adopt modern management practices in its oversight of its member firms.

5.136 The evidence given to the inquiry, indicated that the public, too, was concerned that regulation of the legal profession lacked rigour. The Society believed, because ASIC had granted a class exemption from the Corporations Law that this meant that the Society's rules and practices were adequate to ensure that the mortgage schemes were properly operated, and the clients protected.

5.137 The Committee considers that if resources were so scarce as to inhibit the discharge of its obligations, it was incumbent on the Law Society to report the matter to the regulator, ASIC, and seek the regulator's assistance to develop alternative strategies. This may have included approaching ASIC to develop a strategy for providing more effective inspection and audit services, or have handed the responsibility for regulation back to ASIC.

5.138 The Committee acknowledges that the impact of the fluctuations in the Tasmanian economy, particularly the downturn in its property market, affected the environment in which the schemes operated. However, the Committee also notes that, in fact, other mortgage schemes were in difficulty in States which were not undergoing the same economic fluctuations as Tasmania. Had the conventional loan ratios been adhered to, the problems would have been minimised - irrespective of the condition of the economic environment.

5.139 The Committee considers that the combination of the Society's narrow interpretation of its regulatory role, the lack of rigour with which it executed that role,

as well as its contracting resources inhibited its ability to regulate mortgage schemes effectively.

5.140 The Committee was advised by the Law Society that its Rules of Practice only provided for inspection not audit of the trust accounts. However, the Committee notes that the *Legal Profession Act 1993* authorises the Society to make rules regarding the inspection and audit of trust accounts.

5.141 The Committee was not impressed by the Society's description of Mr Toomey's views on audit and accountability as 'arrant nonsense'. Nor was the Committee impressed with the Society's reluctance to consider a levy on members as a compensatory initiative. The Committee considers such high handed comments as indicative of the Society's unwillingness to wholeheartedly examine its regulatory responsibilities and make an honest assessment of them.

5.142 Furthermore, the Committee considers that the fine semantic distinctions proffered by the Law Society in their interpretation of their existing statutory responsibilities, particularly concerning the distinction between audits and inspections, concealed an unwillingness to critically analyse the way in which the mortgage schemes were conducted, and to take steps to regulate them in accordance with the responsibilities imposed by the ASIC exemptions.

5.143 The Committee also notes that the audit/inspection requirements were there to assist the Society's members as well as the clients who sought the members' advice. The Society's members suffered from the limitations imposed on its audit practices as well as the clients.

5.144 The Committee believes if the Rules themselves had not been narrowly construed by the Society, and had the Society been more proactive in ensuring that the rules were reviewed regularly to keep pace with the changing financial and commercial environment, the effect of the poor practices which led to the schemes' collapse could at least have been mitigated.

5.145 In the view of the Committee more regular independent audits of practices would have assisted the Law Society in its regulatory role.

5.146 The Committee considers that the Law Society could have made more effective use of the trust account inspection reports which were prepared for them. In the view of the Committee the information contained in the inspection reports may have alerted the Society to the problems at a much earlier time.

5.147 The Committee notes that the Law Society's responses to complaints about solicitors appear to have been dealt with less than expeditiously, and that the Legal Ombudsman also expressed concerns about this matter. The Committee considers that this clearly points to a need for the Society to review and improve its complaint handling procedures.

5.148 The Committee considers that any organisation that manages other people's funds must have a consumer protection role and also a moral responsibility to those consumers. Had the Society had a greater consumer focus, the public perception of lawyers as well as the handling of the solicitors' mortgage schemes might have been more positively and efficiently managed.

5.149 The Committee notes that there is an inherent conflict of interest faced by the Law Society in the discharge of its statutory duties. While the Society must, on the one hand, promote the image of solicitors, it must also, on the other hand, also deal with disciplinary matters. In the view of the Committee, the interests of consumers should not be compromised by the Society's advocacy role on behalf of its members.

5.150 The Committee observes that, under current arrangements, the Legal Ombudsman has limited investigative powers and that the Tasmanian Government is currently reviewing the role of the Legal Ombudsman. The Tasmanian Government is also considering the need for an independent body with investigative powers to handle allegations of professional misconduct.

5.151 The Committee also notes the lack of strategic planning by the Law Society, in its responses to the Committee's questions regarding compensation. It is clear to the Committee that there will be a need for further sources of compensation to investors to be considered. In the Committee's view, the Society's evasive responses to the possibility of a practitioners' levy was indicative of its short sighted and narrow approach to the management of all aspects of the mortgage schemes.

5.152 The Committee considers that notwithstanding the ASIC exemption, the responsibility for regulation of solicitors' mortgage schemes in Tasmania rested with the Law Society of Tasmania.

Recommendations

5.153 The Committee recommends that the Tasmanian Government further review the *Legal Profession Act 1993* in order to ensure that the benefit of the amendments to the *Legal Profession Act 1993* and the *Freedom of Information Act 1991* are available to the clients who have lost funds, as well as those who may do so in the future. The review should also consider the following areas:

- **disciplinary procedures and penalties for legal practitioners who are guilty of professional misconduct;**
- **complaints procedures, including independent investigative powers by a separate body;**
- **regular independent audits of legal practices;**
- **consumer information; and**
- **a requirement that the Law Society of Tasmania be subject to regular reviews conducted by an external unrelated body. The reviews should focus**

on the extent to which the Society meets its statutory obligations to its members and their clients.

5.154 The Committee recommends that the Law Society of Tasmania adopt a more strategic, open and less rigidly insular approach to its relationships with consumers as well as its members.

5.155 The Committee is concerned to ensure that the financial burden arising from the action of defaulting solicitors is borne largely by those who have been made the subject of a default order. The Committee notes that the Solicitors' Trust (a separate statutory body established under the *Legal Profession Act 1993* to administer the Solicitors' Guarantee Fund) has the power to recover funds under section 113 of the *Legal Profession Act 1993*, where those funds are paid to a client under a default order against a solicitor.

5.156 The Committee is also concerned to ensure that all victims of failed solicitors' mortgage schemes have access to compensation for the losses they have sustained. In addition to individuals taking civil action against the funds and their managers, the only other source of compensation is the Solicitors' Guarantee Fund. The Committee considers that the Tasmanian Government should amend the Legal Profession Act to allow all victims of failed mortgage schemes, irrespective of whether a default order has been issued by the Court, to have access to compensation from the Solicitors' Guarantee Fund.

5.157 The Committee considers that the Tasmanian Government should also amend the Legal Profession Act to guarantee that where compensation is payable, that compensation includes 100 per cent of the capital invested, together with interest at the rate applying to civil judgments in the Supreme Court.

5.158 The Committee also considers that where a State government acknowledges the existence of solicitors' funds and schemes and has legislated to regulate them, that government has a responsibility to ensure that they are adequately regulated and to provide appropriate consumer protection mechanisms. These should include access to avenues of compensation.

Recommendations

5.159 The Committee recommends that the Tasmanian Government improve access to compensation for all victims of failed solicitors' mortgage schemes.

5.160 The Committee also recommends that the Tasmanian Government continues to ensure that the Solicitors' Guarantee Fund is maintained at a level which is sufficient to meet anticipated needs. This might include legislating to require solicitors to contribute in advance to the fund to ensure an appropriate level of liquidity.

5.161 The Committee is greatly concerned that the Piggott Wood and Baker fund, although in ‘run-out’ mode, is the largest fund still operating, and is not under management by a court-appointed manager despite having significant problems.

Valuation practices

5.162 The Committee heard that there were many problems with some of the valuations given to properties secured under the schemes, and this was a significant contributing factor to the losses from a number of property sales. The Committee notes that, as part of a review of the *Valuers Registration Act 1974* by the Tasmanian Government, proposed new legislation governing valuation practices will prescribe a code of ethics and a more adequate complaints mechanism, and adequate compensation mechanisms to be administered by the Tasmanian Director of Fair Trading.

5.163 The Committee welcomes this development but seeks assurances from the Tasmanian Government that the complaint process will involve a proper hearing of complaints rather than a mere administrative process.

5.164 The Committee notes that the Australian Property Institute (Tasmanian Division) has submitted a proposal which sets out a comprehensive strategy for mortgage lenders and valuers. This proposal requires the mortgagee and the mortgagor to obtain several independent valuations of properties proposed as security. The Committee considers that this proposal has considerable merit, as it may provide some protection against overvaluing and its consequences.

Recommendation

5.165 The Committee recommends that the Tasmanian Government:

- **evaluate the proposal developed by the Australian Property Institute with a view to incorporating its features in its review of the *Valuers Registration Act 1974*; and**
- **consider amending the solicitors’ Rules of Practice to require solicitors to obtain more than one valuation for properties securing mortgages under the solicitors’ mortgage schemes.**

Financial advisers

5.166 The Committee is concerned at the role financial advisers may have played in the many problems which have arisen for clients of solicitors’ mortgage schemes, particularly the lack of product knowledge and the reliance on the material provided by the promoters of the schemes, rather than researching and developing their own material.

5.167 It is clear to the Committee that the significant influx of investments directed into a small number of solicitors’ funds by Garrisons fundamentally altered the scale and nature of the schemes. Garrisons made these investments with little initial

research and no ongoing monitoring of the state of the investments. The firm also displayed little regard for the nature and extent of the fees which would be charged to its clients.

5.168 The Committee notes that lack of reliable consumer information (partly the result of lack of product knowledge) given by Garrisons to their clients was a matter of concern to those clients. In the view of the Committee information on investment options in plain English is a necessary part of client services, and should be provided to all investors.

Recommendation

5.169 The Committee recommends that financial advisers ensure that the consumer information provided to investors in mortgage schemes is concise, in plain English, thoroughly researched and complies with ASIC disclosure and information requirements.

5.170 The Committee notes that during the inquiry ASIC negotiated a rescue plan with Garrisons for their investors. Under the plan, Garrisons have undertaken to repay capital and to pay interest of 6 per cent per annum to clients who lost money through their referrals. The interest will be paid on or before 31 December 2002.

5.171 The Committee commends the Garrisons investor compensation rescue plan, and considers this to be a positive outcome for the inquiry and for the investors. The Committee is anxious to ensure that the momentum for compensating clients of Garrisons is not lost, and encourages ASIC and Garrisons to continue to work towards the fulfilment of a prompt and efficient payment schedule.

Recommendation

5.172 The Committee recommends that ASIC and Garrisons Financial & Retirement Specialists ensure that compensation payments to be made under the rescue package negotiated between ASIC and Garrisons are made to clients without delay.

5.173 The Committee considers that the rescue plan has provided a significant precedent, which demonstrates to investors the importance of dealing with a company which is prepared to stand behind its clients and to make good any shortfalls in the event of financial loss. In the view of the Committee, Garrisons has paid a high price to restore its good name and restore the confidence of investors. The Committee reiterates that Garrisons should be commended for taking this most positive action.

**Senator John Watson
Committee Chair**