

## TABLE OF CONTENTS

|  |                   |
|--|-------------------|
| <b>1. INTRODUCTION</b>                                       | <b>Page 3-4</b>   |
| 1.1 What is this Discussion Paper about?                     |                   |
| 1.2 What is the background to this Discussion Paper?         |                   |
| 1.3 What is the status of this Paper?                        |                   |
| 1.4 Making a submission                                      |                   |
| 1.5 Closing date for submissions                             |                   |
| <b>2. EXECUTIVE SUMMARY</b>                                  | <b>Page 5-8</b>   |
| 2.1 List of questions  |                   |
| <b>3. RETAIL INVESTORS AND THE PROPERTY MARKET</b>           | <b>Page 9-14</b>  |
| 3.1 Retail property investment growth                        |                   |
| 3.2 Finance as a driver                                      |                   |
| 3.3 Risks associated with property investment                |                   |
| 3.4 Risk and investor perceptions                            |                   |
| 3.5 End of the boom: how are investors likely to have fared? |                   |
| <b>4. PROPERTY INVESTMENT ADVICE AND PROMOTION</b>           | <b>Page 15-20</b> |
| 4.1 What activities are we concerned with?                   |                   |
| 4.2 Who provides property investment advice?                 |                   |
| 4.3 Property investment promoters                            |                   |
| <b>5. THE PROBLEMS OF CONCERN</b>                            | <b>Page 21-26</b> |
| 5.1 Introduction   |                   |
| 5.2 Competency/quality of advice                             |                   |
| 5.3 Non-disclosure of information                            |                   |
| 5.4 Exaggerated claims and/or misrepresentations             |                   |
| 5.5 Accountability and redress issues                        |                   |
| 5.6 Unfair, offensive and exploitative conduct               |                   |
| 5.7 Preliminary view of the Working Party                    |                   |
| <b>6. CURRENT LEGAL FRAMEWORK AND REGULATORY ACTION</b>      | <b>Page 27-32</b> |
| 6.1 Introduction   |                   |
| 6.2 General consumer protection laws                         |                   |
| 6.3 Real estate laws   |                   |
| 6.4 Credit laws  |                   |
| 6.5 Financial services laws                                  |                   |
| 6.6 Concluding comments                                      |                   |

|   |                    |
|---|--------------------|
| <b>7. OBJECTIVES OF GOVERNMENT INTERVENTION<br/>AND THE CURRENT LEGAL FRAMEWORK</b>         | <b>Page 33-36</b>  |
| 7.1 What are the objectives of Government in relation to property investment advice?        |                    |
| 7.2 Are Government objectives currently being met?  |                    |
| 7.3 Are Government objectives achievable within the current regulatory framework?           |                    |
| 7.4 Concluding comments   |                    |
| <br>  |                    |
| <b>8. THE SCOPE OR COVERAGE OF REGULATION</b>   | <b>Page 37- 40</b> |
| 8.1 Introduction  |                    |
| 8.2 Who would be protected by any new regime?   |                    |
| 8.3 The regulated activities  |                    |
| 8.4 What “property” would be covered?   |                    |
| 8.5 Regulatory carve-outs?  |                    |
| <br>  |                    |
| <b>9. REFORM OPTIONS AND THEIR IMPACT</b>   | <b>Page 41-51</b>  |
| 9.1 Introduction  |                    |
| 9.2 Reform options  |                    |
| 9.3 Option 1: Retain the status quo – benefits and costs                                    |                    |
| 9.4 Option 2: Additional requirements short of a full licensing regime – benefits and costs |                    |
| 9.5 Option 3: Comprehensive conduct, disclosure and licensing regime – benefits and costs   |                    |
| 9.6 Summary of cost/benefit analysis of options   |                    |
| <br>  |                    |
| <b>10. A STATES AND TERRITORIES’ OR A COMMONWEALTH<br/>RESPONSIBILITY?</b>                  | <b>Page 52-53</b>  |
| 10.1 Introduction   |                    |
| 10.2 Regulation by the States and Territories   |                    |
| 10.3 Regulation by the Commonwealth   |                    |
| <br>  |                    |
| <b>11. ADDITIONAL INFORMATION</b>   | <b>Page 54</b>     |

## **APPENDICES**

|   |                |
|---|----------------|
| <b>A</b> Summary of Regulatory Action               | <b>Page 55</b> |
| <b>B</b> How is financial product advice regulated? | <b>Page 63</b> |
| <b>C</b> Consumer complaints received in 2003       | <b>Page 67</b> |

# **1. Introduction**

## **1.1 What is this Discussion Paper about?**

This Discussion Paper seeks your views about the regulation of advice relating to investment in real estate. For the purposes of the Paper, "advice" is understood to include information, opinions and recommendations of advisers both where the adviser is genuinely independent and where the adviser has a vested interest in promoting the investment or service recommended. We ask:

- Is the marketplace for property investment advice operating efficiently and in a way that adequately addresses the needs and interests of consumers and retail investors<sup>1</sup>;
- Have property seminar operators and other property investment promoters<sup>2</sup> had a detrimental impact? If so, to what extent?; and
- Is the current regulatory framework effective and, if you think it is not operating as well as it should, is the answer:
  - better use of existing laws and other regulatory and consumer education mechanisms, or
  - enhanced regulation?

We also ask for your views on the scope and intensity of a new regulatory scheme, in the event that it was decided to introduce such a scheme. In addition, we ask whether you think primary responsibility for any new scheme should be a States and Territories' responsibility or a Commonwealth responsibility.

In responding to these issues, we ask you to consider the costs as well as the expected benefits of different options for reform, and to state your preferred Option. Options include maintaining the status quo—we would emphasise that no decision to embark on law reform has been taken.

## **1.2 What is the background to this Discussion Paper?**

In 2003, the former Queensland Minister for Tourism, Racing and Fair Trading raised the issue of property investment seminars, and the possibility of national legislation to regulate property investment advice, with the Ministerial Council on Consumer Affairs [MCCA]. The MCCA is the national coordinating body of State, Territory and Federal Ministers with responsibility for fair trading and consumer affairs.

As a result, the MCCA set up a Working Party in August 2003 to consider property investment advice in Australia. The Working Party's Terms of Reference are to:

- assess the extent and nature of the provision of property investment advice in Australia;
- assess the adequacy of current State/Territory and Commonwealth regulation;
- identify possible and/or actual consumer detriment resulting from the provision of property investment advice and assess what aspects of the provision of property investment advice cause consumer detriment;
- examine whether further regulation of the provision of property investment advice is required; and if so, what form such regulation should take; and

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<sup>1</sup> For the purposes of this Paper "retail investors" is intended to encompass Australian individuals and family based businesses, whether incorporated or not.

<sup>2</sup> Property investment promoters are discussed in detail in section 4 of the Paper.

- examine the options for introducing a new national or state regulatory scheme and the costs and benefits associated with each option.

All State and Territory fair trading and consumer affairs agencies, except Tasmania, are represented on the Working Party, together with nominees from Commonwealth Treasury, the Australian Competition and Consumer Commission [ACCC] and the Australian Securities and Investments Commission [ASIC].

This Paper has been produced by the Working Party as a means of seeking feedback on property investment and its regulation from interested parties and the broader community. The Working Party will report the findings of this review, and develop a final report. The report will take into consideration the comments received from this consultation in order to develop a cost/benefit analysis of the options. A recommendation will be made to MCCA based on the option which provides the greatest net public benefit.

### **1.3 What is the status of this Paper?**

This is a discussion paper only. Its purpose is to raise issues and canvas possibilities. It is not itself a proposal for regulatory action, and does not represent the policy of any State, Territory or Federal Government. Any proposed changes to regulation would be a matter for consideration by the MCCA.

### **1.4 Making a submission**

Questions on which we seek your views are set out at the end of relevant sections of the Paper, and in the *List of Questions* that follows as part of the Executive Summary. You should not feel obliged to respond to all the Questions, unless you wish to do so. The final Question also allows you to put any additional issues, views and information to us.

Please note that the contents of submissions may be discussed in the final Report. This will be made publicly available. Submissions may also be subject to Freedom of Information and other laws. These processes should be taken into consideration when making submissions.

The Working Party appreciates and looks forward to receiving your comments, which should be forwarded to:

Property Investment Advice Working Party  
Office of Fair Trading  
GPO Box 3111  
BRISBANE QLD 4001  
Facsimile: 07 3119 0019  
Email: [OFT-P&L@dtftwid.qld.gov.au](mailto:OFT-P&L@dtftwid.qld.gov.au)

### **1.5 Closing date for submissions 15 October 2004.**

Further copies of this Discussion Paper can be obtained by downloading it from the Ministerial Council on Consumer Affairs web site [www.consumer.gov.au](http://www.consumer.gov.au).

## **2. Executive Summary**

This Paper falls into two parts. Sections 3-6 provide information about the property investment market, consumer and marketplace problems, and the current legal framework. In the light of this information, law reform issues are addressed in sections 7-10:

- *Section 3, Retail investors and the property market:* There has been a significant increase in the level of investment in rental properties by retail investors (including individuals and family-based businesses) in recent years. A number of factors have been advanced to explain this increase, including the desire of investors to earn capital gains from investing in rental property, the ready availability of investment finance, and the taxation treatment of investments in residential property. The marketing of property investment and investment ‘training’ would also appear to have been a factor. Risks associated with investment in residential property are noted, including those relating to ‘bubble markets’ for property. The Working Party considers that the current level of investor awareness of these risks may not be adequate.
- *Section 4, Property investment advice and promotion:* For the purposes of this Paper, “advice” is understood broadly to include information, opinions and recommendations where the adviser has a vested interest in, or hopes to obtain financial or other gain as a result of their recommendations, as well as the situation where the advice given can be described as genuinely independent or disinterested. As defined, advice about property investment is currently provided by a range of individuals and businesses, including financial advisers, real estate agents, and seminar operators/ wealth creation promoters. As most of the problems identified by State and Commonwealth agencies relate to the unlicensed promoters [see section 5], this section provides a detailed overview of their operations.
- *Section 5, The problems of concern:* The preliminary view of the Working Party is that there are significant problems associated with the provision of property investment advice and wealth creation training services in Australia today. Key areas identified include:
  - the variable quality of advice services, including concerns about the appropriateness, feasibility and, in some cases legal or ethical character of recommended investment strategies;
  - the lack of disclosure of commissions and arrangements and relationships which promoters have with property developments;
  - misrepresentations that proposed investment strategies are risk-free or very low risk; and
  - failure to provide promised refunds on seminars and courses and the difficulties consumers experience in obtaining redress.
- *Section 6, Current legal framework and regulatory action:* The general consumer protection laws of the various State and Territory jurisdictions, and the Commonwealth, are currently the principal means of dealing with the marketplace and consumer problems referred to in section 5. Other sector-specific laws including the State and Territory real estate and consumer credit laws, and Commonwealth financial services laws may also have some relevance—however, this will generally be limited. This section provides an overview of the laws in question, and alludes to relevant State and Commonwealth agencies’ regulatory activities based on these

laws. Agencies' regulatory activities are further described in *Appendix A* of the Paper.

- *Section 7, Objectives of government intervention and the current legal framework:* The objectives of government in relation to the property investment advice market are to ensure:
  - that the market is transparent and operates consistently with community standards and expectations;
  - that advisory services to retail investors and prospective investors are of a generally high standard; *and*
  - that retail investor decision-making, and ultimately returns for investors, are generally enhanced by property investment advisory services.

The Paper argues that these objectives are not currently being met, and may not be fully achievable within a regulatory framework based primarily on the general consumer protection laws.

- *Section 8, The scope or coverage of regulation:* The Working Party's view is that any new regulatory scheme should be limited to retail investors in real property (including industrial, retail and commercial as well as residential property). Further, a functional approach should be taken by regulating property investment advice in the event that a new scheme were to be introduced—in other words, regulation should generally cover all those who engage in property investment advisory activities (including advice about financing arrangements) whatever the setting or form of the advice and whoever the provider of the advice may be. However, the question of whether there should be a carve-out of any particular types of advice/adviser (for example, real estate agents) under a new scheme is also raised.
- *Section 9, Reform options and their impact:* The Paper considers three broad Options for reform and the costs and benefits of each for consumer, industry and government stakeholders. The Options considered are:
  - Retention of the status quo, perhaps with greater emphasis on its effective utilisation. Even if the objectives of government are not fully achievable within the current regulatory framework, if the additional costs of a new regulatory scheme outweigh the benefits, this would be the appropriate approach;
  - A new 'medium intensity' regulatory scheme imposing additional conduct and disclosure requirements; *and*
  - A new 'high intensity' regulatory scheme requiring those who give property investment advice to be licensed and, as part of this, to meet mandated training and competency requirements, as well as enhanced conduct and disclosure requirements.

The requirements under Options 2 and 3 might be modelled on those applying under the financial services laws in relation to investment advice about financial products (as outlined in *Appendix B*); however, other or variant requirements might also be considered. Views are sought as to which of the three Options should be adopted and what specific regulatory requirements should/should not be imposed.

- *Section 10, A States and Territories' or a Commonwealth responsibility:* This section considers advantages/benefits and disadvantages/costs associated with either State

and Territory or Commonwealth responsibility for a new regime regulating property investment advice.

## 2.1 List of Questions

The questions posed at the end of sections 3-11 of the Paper are as follows:

### LIST OF QUESTIONS

1. What do you see as the key factors driving the growth in retail property investment in Australia in recent years? [Section 3]
2. Have retail investors generally had a sufficient appreciation of the down-side risks associated with property investment? If you think a significant portion have not, can you suggest why this may be the case? [Section 3]
3. How does the market for investment advice about property operate in Australia today? How are advisory services being provided and by whom? [Section 4]
4. Is our characterisation of the seminar operators/investment promoters fair and accurate? If not, in what respects is it inadequate? [Section 4]
5. In your view, are there significant problems associated with the property investment advice and training marketplace? If so, what are those problems and how extensive are they? What is the extent of consumer/investor detriment or loss? [Section 5]
6. Is our characterisation of the problems associated with the property investment advice and training marketplace fair and accurate? Does it cover the main issues sufficiently? If not, in what respects is it inadequate? [Section 5]
7. Leaving aside the unlicensed property investment promoters, are you aware of consumer problems associated with the property advisory activities of professional or trade groups? [Section 5]
8. Do you have any comments on our outline of the current legal framework? Apart from those we have considered, are there other laws or regulatory mechanisms relevant to the regulation of property investment advice and training activities? [Section 6]
9. Do you agree with the stated objectives of government intervention in the property investment advice market place? If not, what should government's objectives be? [Section 7]
10. Are the objectives referred to in the previous question currently being met? [Section 7]
11. Can the objectives of government in relation to property investment advice be realised to an acceptable level within the current regulatory framework? [Section 7]
12. If a new regulatory scheme were to be introduced, what should its scope or coverage be? What activities should be covered, in respect of what types of property, and who should be protected? Do you agree that related advice about the financing of property investment should be covered? [Section 8]

13. If a new regulatory scheme were to be introduced, would a “carve-out” from the regulatory scheme be justified for any particular professional or trade groups, or in respect of any particular activities? If so, why? [Section 8]
14. Is there a role for self-regulatory or co-regulatory mechanisms (for example a voluntary industry code or a mandatory code) in the regulation of property investment advice? [Section 9]
15. If a new regulatory scheme were to be introduced, how detailed and prescriptive should the scheme be? Are there particular regulatory requirements or mechanisms that should/should not be introduced? Should those involved in the provision of advice about property investment be required to be licensed? [Section 9]
16. What is your preferred Option among those outlined in section 9? Why? Are there other or variant Options that we should consider? [Section 9]
17. If a new regulatory scheme were to be introduced, should it be a Commonwealth or a State and Territory responsibility? [Section 10]
18. Is there other information you wish to provide? Are there other issues you wish to raise? Do you have any further comments? [Section 11]

### **3. Retail investors and the property market**

#### **3.1 Retail property investment growth**

There has been a greater level of investment by Australian individuals and family-based businesses [“retail investors”] in rental properties in recent years. By far the larger portion of this investment has been in the residential housing market, rather than in commercial property investment.

According to a recent Productivity Commission report:<sup>3</sup>

- The proportion of households with an investment property has grown from 8 to 12 per cent over the past decade; and
- In the same period, investment loans as a proportion of total housing loans outstanding have grown from around 15 to 33 per cent, with more than 40 per cent of lending approved since 2002 being for investment properties.<sup>4</sup>

It would appear that, even excluding owner occupiers, the average Australian investor has more money tied up in directly held real estate investments than in directly held sharemarket investments.

A number of factors are advanced<sup>5</sup> to explain the increase in property investment by retail investors in recent years, including:

- *Expectations of rising house prices and the desire of investors for capital gain:* Median house prices have increased nationwide at an average annual rate of 12 per cent since the mid-1990s, with prices of home units increasing almost as quickly. In the past two years, annual rates have been closer to 20%.<sup>6</sup> There is evidence to suggest that retail investors are highly responsive to price trends (and less focussed on underlying 'fundamentals' such as population, land release, existing supply, wage growth, interest rates etcetera) in making investment decisions. This responsiveness is arguably reinforced/stimulated by the ready availability of suburb-by-suburb forecasts of continuing gains in house prices that are regularly published in the media;
- *Cheaper and easier access to housing finance:* Interest rates fell through much of the 1990s and, in recent years, have been about half their levels of a decade earlier. In addition, a range of new lending products has come on to the market which has facilitated lending for investment purposes. Moreover, competition in the credit market place has become more intense. The financing of property investment is discussed further in the next sub-section;
- *Taxation treatment of investments:* A critical factor here would appear to be the September 1999 change to capital gains taxation from a real to a discounted nominal

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<sup>3</sup> *First Home Ownership: Productivity Commission Discussion Draft* (December 2003), Productivity Commission, Melbourne. Available at <http://www.pc.gov.au/inquiry/housing/index.html>.

<sup>4</sup> *ibid*, xvi. Note, however, that there have been consecutive falls in the level of finance provided for rental investment properties in recent months, as the investment market has cooled.

<sup>5</sup> These factors are discussed in detail in *First Home Ownership: Productivity Commission Discussion Draft* (December 2003) and *Productivity Commission Inquiry on First Home Ownership: Submission by Reserve Bank of Australia*.

<sup>6</sup> *ibid* xiii (*Productivity Commission Discussion Draft*); *ibid*, Chapter 1.1 (*RBA submission*)

basis. The Productivity Commission notes that this change 'heightened the attraction of investing in property in a period of strong house price growth'<sup>7</sup>;

- *Economic growth generally*: The relative strength of the labour market in recent years may have increased the willingness of households to take on debt for investment purposes. In addition, the growth in average real income has increased households' capacity to fund investment<sup>8</sup>;
- *The downturn in the sharemarket from 2000 to early 2003*: This encouraged investors to look to other asset classes, particularly property, as an alternative investment source. More recently, however, there has been a shift of sentiment and investor funds back to the sharemarket; and
- *Retirement planning by the 'baby boomer' generation*: The aggregate debt-to-income ratio of households has increased in recent years, with the rise being accounted for by an increase in the average debt level of those households with a mortgage. Much of this additional debt appears to have been taken on by mid-life households with relatively high incomes purchasing investment properties, either for capital gain or rental return, as a retirement income source.

Another factor behind the growth in property investment would appear to be what the Productivity Commission has called the "aggressive marketing of housing investment 'opportunities'"<sup>9</sup>. This phenomenon has also been commented on, on a number of occasions, by the Governor of the Reserve Bank. The marketing of housing investment strategies and investment properties is a central theme of this Paper and is considered further at a number of points.

### 3.2 Finance as a driver

Reductions in interest rates in recent years have been accompanied by extensive innovation in the home lending sector. According to the Australian Bankers Association, the number of home loan products has increased by 125 per cent since 1996.<sup>10</sup> Product innovations have included the growth of: redraw facilities and offset accounts; high loan-to-valuation ratio [LVR] loans; early or accelerated repayment arrangements; home equity loans; and loans for 'non-conforming' borrowers.

According to the Productivity Commission, while product innovation has given an impetus to borrowing for both owner occupation and investment, "the changes wrought by increased

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<sup>7</sup> *ibid*, xvii (*Productivity Commission Discussion Draft*); *ibid*, para 16, page 4 (*RBA submission*). The RBA comments: "In Australia, where the top marginal tax rate on income cuts in at a relatively low income (\$62,501), there is a large proportion of taxpayers who are attracted to investments which will lighten their tax burden. This has long been the case and has recently been accentuated by the success which the property investment seminar industry has had in emphasising the tax effectiveness of property as an investment choice. A big attraction of property is the relatively modest after-tax holding cost of even a low-yielding property, due to the way that investments in rental property are taxed."

<sup>8</sup> Since the early 1990s, real average household income has increased by 1 per cent a year; the number of people in full-time jobs has grown by over 900,000 and, in aggregate, real household disposable income has risen by about 30 per cent.

<sup>9</sup> xvi, *Productivity Commission Discussion Draft*

<sup>10</sup> *Productivity Commission Inquiry on First Home Ownership: Submission by Australian Bankers Association* cited p. 37, *Productivity Commission Discussion Draft*.

competition among home lenders appear to have been particularly beneficial for investors”.<sup>11</sup> The Commission continues:

*According to the RBA, lending products for investment in residential property were previously considered 'expensive, inconvenient or hard to acquire'. But finance for such investment is now widely available with product innovations such as home equity loans, split purpose loans and deposit bonds explicitly targeted at investors. Moreover, as noted earlier, competition between lenders has eliminated the interest rate premium on housing investment loans, providing an additional benefit to investors over and above the general reduction in lending margins.*<sup>12</sup>

**Home equity loans** allow households to borrow against the family home to purchase a rental property (or for other purposes).

**Split purpose loans** allow a borrower to split a loan into a personal home loan and a loan for investment in a rental property. The borrower focuses on repaying the home loan, with the accruing interest cost on the investment loan being tax deductible. Prior to the recent decision in *Commissioner of Taxation v Hart*<sup>13</sup> which found that split loan facilities constitute an illegal tax avoidance scheme under the *Income Tax Assessment Act 1936 (Cth)*, split loans were quite widely marketed and used for tax minimisation purposes.

**Deposit bonds** remove the need for a purchaser to provide a deposit at the time of purchase. The issuer of the bond (often an insurance company) guarantees the payment of the deposit at settlement in return for a fee. Deposit bonds are more commonly used for off-the-plan purchases where settlement may be as long as three years from contract exchange. The RBA has estimated that such bonds are used in 20 per cent of residential purchases in Sydney.<sup>14</sup>

Another driver of borrowing for property investment purposes (as well as owner occupation) has been the entry of mortgage originators and mortgage brokers into the home lending market since the mid 1990s.<sup>15</sup> It is estimated that mortgage brokers now arrange over 30% of housing mortgages in Australia. All the major mortgage brokers offer to arrange investment loans as part of their service. There are indications that mortgage originators and the mortgage broking industry (which is largely commission-driven) have promoted investment loans with some vigour in recent years.

### 3.3 Risks associated with property investment

As we noted above, it would appear that the average Australian investor has more money tied up in directly held real estate investments than in directly held sharemarket investment. Importantly, too, real estate investments are more narrowly held than their sharemarket equivalents—an investor is likely to have just one or two investment properties, versus a wider portfolio of shares. This obviously increases the potential detrimental impact of a poor investment decision on individual investors.

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<sup>11</sup> p. 39, *Productivity Commission Discussion Draft*

<sup>12</sup> *ibid*

<sup>13</sup> *Hart [2004] HCA 26*

<sup>14</sup> *ibid*

<sup>15</sup> *Mortgage originators* are retail or wholesale lenders that raise funds by issuing securities in the money markets (securitisation) rather than primarily lending against deposit monies. *Mortgage brokers* are financial intermediaries that help borrowers find and arrange home loans.

Secondly, inherent features of the property market mean that there appears to be a stronger tendency than in other markets for asset price 'bubbles' to develop from time-to-time. An asset price 'bubble' is said to exist where price increases in the recent past encourage investors to expect further price rises going forward, and to invest speculatively in expectation of these, thus further 'bidding up' prices. Eventually, prices overshoot appropriate levels, given the fundamental or underlying market conditions, and there is a correction—the 'bubble' either bursts (prices fall) or deflates slowly (a period of price stagnation occurs).

However, because of such factors as the relatively high transaction costs associated with the transfer of real estate, and the 'lag' time before new housing stock can be supplied to meet an increase in demand, asset price inflation may continue for some time in the property market before a correction occurs.

This tendency for asset price bubbles to occur, whether in the property market as a whole or in particular sub-markets, has obvious implications for investors. In particular, it means investors who buy at or near the top of a bubble market are likely to pay too much and may suffer a loss on their investment, whether in absolute dollar terms or after accounting for inflation.

Admittedly, there are factors at work limiting price volatility in the housing market. For one thing, the high level of owner-occupation of real estate ensures a significant degree of market stability. Seventy per cent of Australians are owner-occupiers, and these asset-holders as a class are generally unlikely to sell into a falling market (unless forced to do so by unemployment or other extreme circumstance). In addition, there is evidence that Australian property investors are reluctant to 'crystallise' losses on investment properties and tend to hang on to real estate during market downturns to a greater extent than with other types of assets (although not necessarily to the same extent as owner-occupiers). This also limits residential property price instability.

However, the potential price volatility of property markets should not be underrated either. As the Productivity Commission notes:<sup>16</sup>

*Notably, a recent International Monetary fund study (Bordo and Jeanne 2002) concluded that property price booms are three times more likely to be followed by a bust than a boom in the stock market. The sharp fall in house prices in Sydney following the collapse of the boom in the 1980s provides an Australian illustration of the boom-bust phenomenon.*

At a more disaggregated level, too, greater price volatility can be expected in sub-markets dominated by investors, such as the inner city home unit market. This is because investors are *relatively* more likely to sell where there is a market downturn, particularly if they are highly geared.

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<sup>16</sup> p. 139, *Productivity Commission Discussion Draft*

### 3.4 Risk and investor perceptions

How adequately do retail investors as a group perceive the risks associated with property investment referred to in the previous sub-section? Recent experience suggests that there may be a degree of under-recognition of the risks. This view is developed in the following paragraphs.

As with other assets, returns on real estate as an investment have, broadly, two components—a return from earnings (rental income in the case of real estate) and a return from capital gain (the change in the value of the property from time to time). Until recently at least, residential property investment continued to be very strong notwithstanding the increasingly poor rental yields investors were able to achieve.

Further to this, at the end of 2003 gross rental yields on residential property had reached a very low 3.5% (with cash rates at approximately 2.5% after payment of rates, management fees, strata levies, maintenance etcetera), according to the RBA.<sup>17</sup> This compares unfavourably with residential property yields in some overseas markets.<sup>18</sup> It also compares unfavourably with 8-9% yields for industrial, office and retail property. The RBA comments that the industrial, office and retail yields “are the sorts of yields required to get professional investors to invest in property, yet households are investing at less than half these yields”.<sup>19</sup> Moreover, investment in property continued strongly even after returns from earnings on shares and bonds started to out-perform earnings from residential real estate.

Presumably, investors have been willing to accept the relatively poor returns from earnings on residential property investment because they expected further excess capital gains from housing—that is, gains over and above what might be expected from other types of investments.

What is striking about this situation, however, is that these stronger capital gains were apparently anticipated (and may still be anticipated) even though there have been consistently strong rises in housing prices for a number of years, including particularly strong rises in the last two years.<sup>20</sup> Equally striking is the fact that speculative investment has been strongest in the Melbourne and Sydney markets which have already had the strongest recent capital gains (and where rental yields have been lowest).

In the view of the Working Party, these circumstances may suggest a level of under-recognition of the risks associated with investment in the property market and with 'bubble' pricing, in particular. In short, have average retail investors, particularly highly geared investors, been sufficiently cognisant of the potential for a market correction, and the implications for their investments of such a correction?

If, as we suspect, there has been under-recognition of risks associated with property investment, this may be due to a number of factors. It may be due in part to the tangibility of real estate and, going with this, an ingrained perception that property is a solid investment—literally, bricks and mortar—as opposed to merely "paper investments" in securities, cash, bonds etcetera. Related to this, people tend to feel they understand real estate and the real estate market. Perhaps, there is also a perception, stimulated by popular television programs

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<sup>17</sup> p. 3 (para. 11), *Productivity Commission Inquiry on First Home Ownership: Submission by Reserve Bank of Australia*

<sup>18</sup> *ibid*

<sup>19</sup> *ibid*

<sup>20</sup> see para 3.2 above

and magazines, that the property market is an exciting game. The strong capital gains in property in recent years, relative to share prices, are likely to have reinforced all these attitudinal factors.

However, there may be other factors at work as well, including differences in the regulatory framework applying to different asset classes. For instance, does the current framework for advice about property investment impose any significant pressure on promoters to warn prospective investors about the downside risks associated with their property investment strategies? We consider the regulatory framework for property investment advice later in this Paper.

### **3.5 End of the boom: how are investors likely to have fared?**

The general, although not universal, view of commentators would appear to be that an asset price bubble developed in the residential property market during 2002 and 2003, particularly in the inner city investment unit market, and that an adjustment is now taking place.

Generally, there appears to have been a deceleration in average price growth in most cities, as well as reduced auction clearance rates. As far as the investment unit market in particular is concerned, we understand that prices of new apartments have fallen in some cities; that several high density projects have been cancelled; and that vacancy rates are in aggregate on the increase. These trends are likely to continue, at least in the short term, given that lending for residential investment has been declining in recent months.

In these circumstances, it is reasonable to conclude that a proportion of investors—particularly if they have paid top-of-the-market prices for inner city investment units—may suffer significant losses. In addition, our agencies are aware of cases where investors have adopted high-risk borrowing strategies to fund multiple investments and are likely to be forced into mortgage default. This latter situation is discussed further in section 5 of this Paper.

#### **Question 1**

What do you see as the key factors driving the growth in residential property investment in Australia in recent years?

#### **Question 2**

Have retail investors generally had a sufficient appreciation of the down-side risks associated with retail property investment? If you think a significant portion have not, can you suggest why this may be the case?

## **4. Property investment advice and promotion**

### **4.1 What activities are we concerned with?**

The key element of property investment advice, for the purposes of this Paper, is the actual or reasonably inferred intention to influence consumers and investors' decisions about property investment. Thus, "advice" should be understood broadly here as encompassing, as well as independent information, recommendations or opinions, other activities that are, or are more akin to, for instance, promotional or marketing activities (whether acknowledged as such or not).

The term "advice" is also intended to encompass both general advice (for instance, about capital gains associated with property investment), and advice which is or purports to be tailored to a particular individual or household's financial objectives or circumstances (why *you* should buy an investment property given your income, assets, stage of life etcetera). Both general and tailored or personal advice may be given in a range of contexts and settings (individual consultation, web site, public forum) and by a range of different types of individuals.

### **4.2 Who provides property investment advice?**

Property investment advice may be sought from, among others, professional advisers, including accountants and financial planners. We understand, for instance, that there are financial planning groups that specialise in property investment advice, and/or provide such advice as part of their broader service.

Many real estate agents give general financial advice to potential buyers of investment properties. Typically, this takes the form of advice about the likely capital appreciation or rental incomes from a property – basically, its investment return potential. Sometimes agents' advice will include some general taxation advice as well, such as about the benefits of negative gearing.

The extent to which, apart from general advice, real estate industry representatives are also engaged in providing tailored or personalised financial advice is not clear to us, and we would be interested in receiving your comments on this.

There are also buyers' agents who select properties and negotiate purchases on behalf of investors and home buyers.

In addition, extensive marketing and promotion of property investment and property-related 'wealth creation' training is currently undertaken by individuals and groups that do not fit neatly within any professional or trade category. These people tend to operate outside the traditional real estate agent/client context, although some may be real estate industry representatives. Some of these promoters are associated with property development businesses, while some simply describe themselves as 'ordinary Australians sharing their experiences' and in similar terms. Their critics commonly refer to at least some of these people as 'property marketers', 'property spruikers', 'get-rich-quick operators' etcetera.<sup>21</sup> In

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<sup>21</sup> Terms like 'marketeers' and 'spruikers' etcetera are also used in connection with seminar operators promoting share-trading strategies and software programs.

this Paper we describe them as ‘property investment promoters’ or ‘property investment marketers’.

As property investment promoters have been the main focus of recent concerns about advisory activities in the property area, they are further described in the following paragraphs. Section five then considers some of the problems associated with the property investment industry.

### **4.3 Property investment promoters**

#### *Overview*

Property investment promoters have been a feature of the Australian investment scene for at least a decade. In the mid 1990s, they were associated, in particular, with the property boom in South-East Queensland. Properties were generally marketed interstate, in many cases at prices considerably in excess of local-market prices—hence the common description of the scheme operators as "two-tier marketers". Their techniques included extensive cold-calling of potential investors, high-energy promotional evenings, free or subsidised inspection flights, allegedly expert and independent advice provided at seminars, and the arrangement of finance to cover purchases of investment home units.

Since at least 2002 there has again been extensive promotion of real estate investment seminars or workshops using mass advertising and direct marketing techniques. In contrast to the scheme promoters described in the previous paragraph, the activities of some of this latest generation of marketers have been focused primarily on the sale of educational, training and motivational material—including seminars and workshops, self-help manuals, books, videos, CDs etcetera—rather than on the sale of interests in property as such.

However, other recent property marketers have been primarily concerned to stimulate sales of real estate, especially of units in newly-built or (more commonly) planned CBD apartment developments in, in particular, Melbourne, Sydney, Brisbane and Perth.

In other cases still, rather than (or as well as) promoting direct purchase of real estate, promoters have sought to encourage prospective investors to purchase interests in managed investment schemes, or to provide investment funds to companies seeking additional funding for proposed developments, including through so-called mezzanine financing arrangements. In these latter cases, the investor’s interest in the scheme or development will not necessarily be secured over real property. Finally, some property marketers have adopted a range of, or all, these strategies.

#### *How property investment promoters operate*

A number of aspects of the operations of property investment marketers may be briefly noted. While we acknowledge that there are a diversity of practices and approaches among marketers (and that approaches may be currently in a state of flux as a result of changing market conditions), the following generalisations are broadly applicable, in our view:

- There is a consistent message in marketers' advertising, seminars and related material that property is a better investment than other options. This is typically supported by an emphatic emphasis on sustained strong asset growth,

low interest rates and good rental returns. There is correspondingly little, if any, emphasis on downside risks associated with property investment;

- In some cases, promotional material is very overstated and manipulative. Some promoters represent that very large returns can be generated in a short time and with virtually no risk being assumed by the investor. This marketing typically promises to reveal the 'secrets of the rich and successful' and suggests that getting rich through property investment is easy — you only have to be prepared to try;
- Marketers typically offer to assist 'ordinary Australians' to achieve their financial objectives, and it would appear that a wide range of consumers/potential investors respond to their publicity. Occupational groups that have figured prominently at seminars include semi-retired people, business managers, small business owners, and various types of professional and semi-professional people. In addition, there would appear to be some participation by more financially marginal groups including people in semi-skilled or unskilled occupations, single parents, people who do not own their home or other significant assets, and some unemployed people;
- Seminar participants interviewed by State and Commonwealth agencies, or featured in the media, frequently cite motivations such as:
  - concern about the performance of their existing investments (for example, in shares or managed investments);
  - fear of ending up poor or not having enough in retirement; and
  - the desire to break out of their current financial difficulties

as factors motivating their attendance at initial free seminars or consultations, and in paying for further courses and other material, as well as in making property investments. The motivational content of advertising, seminars and other presentations/ materials appears to be generally responsive to—indeed, it plays on—people's fears and concerns<sup>22</sup>;

- The free initial seminar or workshop is a frequent feature of the operations of property marketers. Typically, these initial seminars foreground motivational issues and audiences' aspirations but provide little detail about specific investment techniques. In the case of investment marketers whose primary focus is the sale of training in 'wealth creation' strategies, the initial workshop is generally used to recruit participants to sign-up for further courses and/or other materials at which, it is typically promised, highly reliable but little-known techniques will be revealed. Follow up courses may deal exclusively with property (sometimes dismissing investment in other asset classes), or may also canvass other forms of investment as well;
- The costs of follow-up courses vary greatly, but they can be very high. We understand, for instance, that the typical cost of the 'basic' training program offered by one nationally-operating promoter was \$15,000, with premium programs costing \$55,000 or more. During 2003, another promoter was

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<sup>22</sup> For instance, one wealth promoter's current advertising notes that '9 out of 10 Australians will retire on an income below the median wage'.

charging nearly \$5,000 for a 4-day workshop. Another operator is currently charging over \$17,000 for its program, assuming the participant pays by instalments<sup>23</sup>;

- Seminar workshops and courses are frequently advertised and promoted as 'educational' services only and as not involving the giving of advice. Nonetheless, in some cases, at least, the promoter can be reasonably regarded as intending to influence consumers to make particular investment decisions. Further to this, some operators promise that consumers will have their own 'mentor' assigned to them to assist them to develop strategies suitable to their particular circumstances;
- Promoters generally offer to arrange finance for people who cannot afford to pay for seminars and other materials from their own resources. We understand that loan applications are frequently completed at introductory seminars and that a significant number of people have taken out loans to pay for the courses of some promoters. At least one promoter assists consumers to apply for an increase to the limit on the consumer's credit card to pay for his courses;
- Concerns about spending or borrowing large sums to finance courses are frequently assuaged by promises by the marketer of a money-back guarantee or refund if the participant is not completely satisfied with the course. These guarantees may require the participant to withdraw from the course by a certain point, or, alternatively, may be conditional on the participant first completing a part, or all, the course;
- As is discussed further below, some of the investment strategies explained and recommended at follow-up seminars would appear to be of a high-risk nature and/or to involve considerable sophistication and entrepreneurial skill. In some cases, too, conduct appears to be recommended which most people would regard as unethical;
- Property marketers seeking to persuade seminar participants and other potential investors to invest in particular residential developments frequently present themselves as being able to 'source' property at better or substantially better than market rates. Sourcing fees are sometimes charged. Generally, marketers will either have an interest in the proposed investment or receive commission for recommending it. However, these interests and incentives are generally not disclosed in marketers' promotional material and presentations, or, if disclosed, are backgrounded or discounted as not significant;
- These types of seminars are also sometimes characterised by the promoters as involving education or information only and as not constituting the giving of advice—although, on any definition, this is untrue;
- Marketers offering property investment opportunities usually also offer to assist potential investors with financing arrangements, and frequently either

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<sup>23</sup> We are also aware of very high-cost written and electronic materials. In one admittedly rather extreme case, a retiree with a modest fixed income advised that he/she had paid \$3,000 for a CD-Rom that promised to reveal the secrets of property development hitherto known only to the very rich.

have representatives of finance providers present at their presentations or arrange for finance representatives to contact investors. The use of deposit bonds<sup>24</sup> has been a frequent aspect of the financing arrangements promoted by a number of marketers in the last couple of years;

- Another technique being promoted is the use of vendor finance arrangements. Vendor finance is an agreement where the owner of a property (often called a 'wrapper') offers finance to the purchaser. Typically, the purchaser pays a higher rate of interest than for a standard home loan, and they may also pay a premium on the purchase price. Importantly, the purchaser does not become the owner of the property until the debt to the vendor has been paid in full. As such, their rights are limited; and
- For instance, if the purchaser does not maintain payments under a vendor financing arrangement they lose possession and, with this, the benefit of all prior payments and all money spent on maintenance, renovations and rates. In addition, if the vendor has borrowed to finance the property and the *vendor* defaults on that loan, the purchaser will lose possession even though they are not in default. The purchaser's only recourse may be legal action against the vendor who may have no assets.

#### *The extent of property marketer operations*

State and Commonwealth agencies do not have global figures on the size of the property marketer 'market' either currently or over the last couple of years. We believe there is quite a fluid market and that promoters come and go.<sup>25</sup> On the basis of complaints received and media monitoring, we believe there has been a contraction in seminar operations in recent months. However, seminars are certainly still being promoted and conducted, and there is evidence that marketing operations are continuing by other means as well.<sup>26</sup>

Information provided to ASIC by seminar promoters in 2003 suggests that, at the height of the property boom, a number of property investment businesses had extensive (and it would seem, highly profitable) operations. For instance:

- One nationwide operator advised that 20,000 clients had attended its courses prior to May 2003. (However, on a subsequent current affairs television program, the promoter claimed 100,000 individuals had attended their seminars.) This promoter claimed a \$37.5 million turnover during 2001-2002, and expected strong growth in the 2002-03 financial year;
- A second promoter, which advertises in one city only, said it had attracted over 4,100 participants between 2001 to mid 2003, and had received over \$20 million in fees for three types of seminars offered. An additional 654 people attended seminars where the costs are unknown; and
- A third promoter advised that 75,000 people had attended its seminars up to mid 2003. Approximately 1,000 people were present at an introductory seminar given by this promoter and attended by ASIC staff. The introductory seminar cost \$59 per person or \$49 for groups of 3 or more. At a four-day follow-up workshop costing \$4,997 per person there were 447 attendees. (At \$4,997 per person this means that

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<sup>24</sup> See Para. 3.7 above.

<sup>25</sup> One consumer advocate recently estimated that there are currently about 70 'active players' in property marketing; however, we are unable to confirm this figure.

<sup>26</sup> These include (email) spam, direct marketing, telemarketing and door-to-door selling.

the promoters generated income of about \$2.2 million.) Figures are not available as to how many such workshops have been held.

**Question Three**

How does the market for investment advice about property operate in Australia today? How are advisory services being provided and by whom?

**Question Four**

Is our characterisation of the seminar operators/ investment promoters fair and accurate? If not, in what respects is it inadequate?

## **5. The problems of concern**

### **5.1 Introduction**

As has been noted above, most of the problems associated with property investment advice and wealth creation training activities of which State, Territory and Commonwealth agencies are aware relate to the activities of individuals and entities we have called ‘property investment promoters’.<sup>27</sup> It is with these problems that this section is primarily concerned. (This section assumes your familiarity with the material on investment promoters in section 4.)

You may be aware of problems associated with other types of property investment advisers. If so, Question 7 below gives you the opportunity to comment on any such problems.

The issues set out in this section summarise:

- information provided to our agencies by complainants, consumer representatives and industry participants<sup>28</sup>;
- evidence gathered during surveillance and investigations undertaken by some State and Commonwealth agencies, or which has emerged during the course of various legal proceedings undertaken<sup>29</sup>; and
- information gathered by media and other sources.

Most of the concerns summarised have been raised on multiple if not numerous occasions, and by multiple sources, and this tends to confirm their legitimacy and representativeness. Nonetheless, Question 6 below specifically asks you whether, in your view, our characterisation of the consumer problems associated with property investment advice and wealth creation training services is fair, accurate and reasonably complete.

The main issues and concerns are summarised under the headings that follow. There is, of course, considerable overlap.

### **5.2 Competency/ quality of advice**

A common theme of complaints to State and Commonwealth agencies is that properties are recommended by advisers on the basis that they represent excellent value, emphasized by optimistic financial models involving sustained strong asset value growth, low interest rates and good rental returns. The investor subsequently realises that he or she has in fact paid much more than they should have, given the price of comparable properties at the time of purchase. The charging of 'sourcing fees' by the promoter, which appears to be quite common, often compounds the investor's sense of having been cheated. Poor advice about price frequently goes hand-in-hand with the non-disclosure of conflicts of interest by the promoter: see next sub-section.

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<sup>27</sup> See section 4, paras. 4.9 to 4.15.

<sup>28</sup> Nationally, there have been several hundred complaints to government agencies in the last 12 months, and some agencies (including the ACCC and ASIC) continue to receive complaints on a regular basis. Publicity associated with the liquidation of the National Investment Institute and other businesses associated with Henry Kaye has generated a significant level of complaints against this promoter. However, there have been many complaints both against other nationally-operating marketers, and more small scale operators. See *Appendix C*.

<sup>29</sup> For details, see *Appendix A*.

Another common theme of complaints is that advisers do not warn investors of the down-side risks associated with the strategies they recommend. These may be considerable. For instance, people who are persuaded to purchase over-priced investment properties, particularly off-the-plan, are often also persuaded to adopt high-risk financing arrangements to fund their investment.

Thus, investors are encouraged to buy an investment unit, and in some cases multiple units, off-the-plan using deposit bonds<sup>30</sup> to guarantee payment of the deposit at settlement. Many of these investors do not anticipate settling and a proportion would have difficulty raising the required finance to do so. Promoters persuade them, however, that they should not be concerned about this because, between exchange and settlement, they will be able to resell at a significant profit and never have to settle.

Of course, this strategy may already be compromised if the buyer has paid too much for their investment property. Indeed, even if the buyer has not bought at the top of the market, developers will generally have factored future capital gain into their pricing. The strategy also depends on being able to sell into a continuing rising market, and on being able to realise a capital gain in a couple of years (the period it will take to build the apartment complex) sufficient to offset the transaction costs associated with the investment. Little, if any, emphasis would appear to be given to these down-side risks by the investment marketers that promote them.

Our agencies are aware of cases where investors have failed to complete their purchases and now face being sued by the deposit bond issuer. In other cases, although the investor settles, the net return on the investment is negative.

Unsophisticated investors are also persuaded to borrow against their homes to invest in mezzanine lending schemes on the promise of high interest earnings. These investor-lenders might get a second mortgage over the development as security. However, in the event of default by the developer, this second mortgage is only of any value if there's enough money left over after the bank with the first mortgage is paid. If, in these circumstances, the market turns down by say 10% (as has occurred in some investment unit sub-markets) there is considerable risk of investor loss. Again, however, promoters with an interest in the development for which funds are sought do not advise of these risks.

Concern has also been expressed about the failure of property advisers who promote 'wrapping' or vendor finance arrangements to warn consumers of the significant risks associated with these arrangements<sup>31</sup>. Vendor finance is often promoted to potential purchasers who are unable to obtain finance from more conventional sources.

Another common theme of complaints about the quality of advice given by property investment advisers is that it is simply not practical. For instance, people who themselves have no money to invest are told they can still become rich by 'spotting' good investment properties and then finding others with available investment cash and persuading them to form a syndicate and use their equity to raise debt to make the purchase. The spotter would then take an equity stake in the syndicate that owned the property. Not surprisingly, complainants do not regard this as a workable or feasible strategy for most people. Other apparently impractical strategies promoted include adding greatly to the value of properties

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<sup>30</sup> See para. 3.7 above for a description of deposit bonds.

<sup>31</sup> See paras 4.13.14 and 4.13.15 above

through minimal 'cosmetic renovation'; and buying, renovating and selling properties over a short period at a considerable profit, notwithstanding the transaction costs involved.

### **5.3 Non-disclosure of information**

A key issue here is the non-disclosure of the payment of commissions and other benefits to promoters who persuade people to invest, either directly in particular properties, or in various types of property investment vehicles and schemes. The non-disclosure of relationships or associations the promoter has with a property development or scheme it recommends raises similar issues.

Our agencies have received many complaints from people who have attended high-priced seminars or workshops. Many of these consumers/ investors state that they had assumed the advice they received, and sometimes paid heavily for, was genuinely independent and objective. They only subsequently realised that the promoter had significant conflicts of interest and was, indeed, in many cases little more than a sales agent, or harvester of investment funds, for a development in which the promoter had an interest. When asked, complainants frequently indicate that they may have been more circumspect had they known about the promoters' interests before they followed their advice.

On the basis of our agencies' experience, we consider that property investment promoters are frequently conflicted but rarely disclose their conflicts of interest. To take one example, during 2003 ASIC examined 25 client files maintained by one promoter. They showed that clients were advised to use the equity in their homes to purchase real estate as an investment. Specific investment properties were recommended; however, the promoter's interest in the real estate recommended was not disclosed to any of the clients.

Another area where information disclosure appears to be inadequate is in relation to the nature of the interest that the investor acquires. Investors, and prospective investors, appear quite frequently to be confused about exactly what they have or will obtain by way of security if they place their funds with a promoter. For instance, some investors assume, or are led to believe, that their funds will be invested directly in a property, or that they will be secured creditors. In fact, the arrangement these investors have entered into, or are proposing to enter into, may do no more than give the investor an unsecured interest in a 'two dollar' company.

In other cases, they may be second mortgagees, with an institutional lender having the first mortgage over the property. This typically happens in mezzanine financing arrangements. Many investors who enter into these arrangements appear not to realise that the value of their security will depend on market fluctuations and that any downturn in the property market (such as has occurred in some markets in recent months) may leave them substantially exposed.

## **5.4 Exaggerated claims and/or misrepresentations**

Apart from the non-disclosure of information, State and Commonwealth agencies have received numerous complaints about representations made in advertising and/or seminar presentations that are, at least, highly coloured and exaggerated, and that in some cases are likely to constitute misleading and deceptive conduct or false and misleading representations: see paragraphs 6.3 to 6.8 under *General consumer protection laws*.

Representations about very large returns that can be generated in a short period might be noted in this context. Widely-circulated claims we have seen include:

- that the promoter can teach you how to turn \$7,990 into \$225,000 in as little as three months;
- that the promoter can make ordinary Australians 'property millionaires' in just six months 'using no money down, no debt and no equity ...'; and
- that the investor can achieve 1582% 'quick cash' return on their investments 'in as little as three months'.

Claims that the investments or techniques promoted are foolproof or virtually so might also be noted. The foolproof or low risk nature of proposed strategies is a frequently reiterated theme. Agencies have received numerous complaints from people who have lost money as a result of adopting property and property financing recommendations that were promoted as 'risk free', '10-35% capital guaranteed with no chance of losing your money' and in similar terms.

## **5.5 Accountability and redress issues**

As we noted in the previous section, concerns about spending or borrowing large sums for investment courses or related training materials are frequently assuaged by promises of a money back guarantee or refund if the consumer is not satisfied with the course or training materials and/or if they withdraw by a certain stage. However, one of the most frequent types of complaint made to government agencies in this area concerns the difficulty of obtaining promised refunds.

In cases where the refund depended on withdrawal by a certain stage, seminar attendees have frequently complained that courses were structured so that modules ran into each other and no real opportunity was provided to withdraw. Others complained that when they indicated their intention to withdraw, consultants assured them that the guarantee would be extended. However, these assurances were generally not honoured.

## **5.6 Unfair, offensive and exploitative conduct**

Complainants to State and Commonwealth agencies regularly note aspects of property investment seminar operations that the complainants found to be manipulative and/or offensive and which they regarded, either at the time or in retrospect, as being part of high pressure selling strategies. Staff of agencies who have attended seminars have generally made similar observations.

Concerns that are frequently referred to in this context include:

- aggressive and insistent strategies to make people feel 'small'—that they are 'losers'—because they have achieved only limited financial success in life. Presenters play upon people's genuine anxieties about their financial future and sense that they ought to have achieved more financially;
- creation of an atmosphere of hurry and urgency—that there are opportunities that are not going to be repeated and that if you do not commit now, you will miss out for good (and will continue to be a 'loser' etcetera);
- creation of a sense that it's all really quite easy—buying property investment, or property investment expertise, is presented as just like purchasing fast-moving consumer goods—it is almost as uncomplicated, the 'product' is equally assured etcetera;
- unwillingness of presenters to allow opportunities for questions or discussion;
- belittling or deriding of participants who raise questions or indicate a degree of scepticism about benefits or promised returns or the ease with which these can be achieved;
- seminars that run for many hours and seem designed to wear participants down thereby reducing peoples' initial caution about making further commitments; and
- as part of this, making it physically difficult or otherwise awkward for people to leave the seminar location.

Our agencies have also received complaints from low income and otherwise vulnerable consumers. We are aware of a number of cases, for instance, where unemployed people were induced to borrow thousands of dollars to attend courses on the basis that the course would assist them to improve their situation. In some of these cases, people claim they are currently required to pay amounts up to \$400 per fortnight in loan repayments.

A number of complainants falling into this category have noted that wealth creation strategies recommended in the courses they attended were largely or entirely irrelevant or unworkable given their circumstances. For instance, many recommended strategies depend on using the equity in the consumer/ investor's existing home. This is not a strategy that people who do not already own property or other significant assets can utilise.

The very high fees that some promoters charge for their investment seminars and related materials might also be considered under this heading. To take an admittedly rather extreme instance, one promoter during 2003 was offering pro forma real estate contracts for sale at a cost of up to \$8,995.

### **5.7 Preliminary view of the Working Party**

In the light of the material set out in this section and the preceding section, the Working Party is of the view that there are significant problems associated with the provision of property investment advice and wealth creation training services in Australia today. The next section outlines the current regulatory framework. In subsequent sections, we consider whether the problems we have noted can be adequately addressed within that framework (for example, by better utilizing existing laws), or whether further law reform is required.

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|-------------------|
| <b>Question 5</b> |
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In your view, are there significant problems associated with the property investment advice and training marketplace? If so, what are those problems and how extensive are they? What is the extent of consumer/investor detriment or loss?

**Question 6**

Is our characterisation of the problems associated with the property investment advice and training marketplace fair and accurate? Does it cover the main issues sufficiently? If not, in what respects is it inadequate?

**Question 7**

Leaving aside unlicensed property investment promoters, are you aware of consumer problems associated with the property advisory activities of professional or trade groups?

## **6. Current legal framework and regulatory action**

### **6.1 Introduction**

In this section we provide a brief overview of legislation that may be relevant to the issues and conduct described in the previous two sections. Our purpose here is to assist general, non-expert readers to understand, in broad terms, the nature and scope of current legislative provisions to the extent they are relevant to property investment advice and wealth creation training activities. Inevitably, there has been some simplification and a great deal of detail has been left out. Also, we have not considered general law principles and remedies, although these may be relevant in some circumstances.

State and Federal agencies provide further information about the legislation they administer on their web sites; and there are, as well, a range of detailed, technical commentaries generally designed for legal, professional and business readers.

### **6.2 General consumer protection laws**

All State, Territory and Federal jurisdictions have general consumer protection laws, based on the *Trade Practices Act 1974 (Clth)*, which are administered by their fair trading and consumer protection agencies.<sup>32</sup> These laws apply economy-wide.<sup>33</sup> Among other things, these laws prohibit a range of unfair conduct in the provision of goods and services by traders and suppliers, broadly understood. This could include people engaged in the supply of property investment advice or educational services.

Conduct prohibited under the general consumer protection laws includes:

- misleading or deceptive conduct;
- false or misleading representations; and
- unconscionable conduct.

A few comments on each of these prohibitions follow:

- *Misleading conduct*: To establish that conduct is misleading and deceptive under the general consumer protection laws it is not necessary to show that there was any intention to mislead or deceive, just that there is a reasonable possibility that persons to whom the conduct was directed—the 'target audience' (which could be the general public or a more limited audience)—would be misled or deceived. Misleading or deceptive conduct has been alleged in sets of proceedings undertaken by both the ACCC and ASIC against Mr. Henry Kaye and the National Investment Institute. These are described in Appendix A;
- *False or misleading representations*: Some misleading conduct may also constitute a false or misleading representation, thereby attracting the possibility of criminal sanctions as well as civil liability. There are a number of categories of false or

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<sup>32</sup> *Fair Trading Act 1992 (ACT)*, *Fair Trading Act 1987 (NSW)*, *Consumer Affairs and Fair Trading Act (NT)*, *Fair Trading Act 1989 (Qld)*, *Fair Trading Act 1987 (SA)*, *Fair Trading Act 1990 (Tas)*, *Fair Trading Act 1999 (Vic)*, and *Fair Trading Act 1987 (WA)*.

<sup>33</sup> Note, however, that the *Trade Practices Act 1974 (Clth)* excludes 'financial services'. However, provisions largely mirroring the *TPA* provisions in relation to financial services are set out in Part 2, Division 2, *ASIC Act*. This legislative division reflects the division of consumer protection responsibility at the Commonwealth level between ACCC and ASIC. See further under *Financial services laws* at 6.18ff below.

misleading representations. These include falsely representing that goods or services are 'of a particular standard, quality, value or grade' or that they have 'sponsorship, approval, performance characteristics, uses or benefits they do not have'. False representations about price, the need for the good or service, the 'existence, exclusion or effect of any condition, warranty, guarantee, right or remedy' and other matters can also be impugned under this prohibition. In the above-mentioned proceedings against Mr. Henry Kaye and the National Investment Institute, false or misleading representations are also alleged; and

- *Unconscionable conduct*: Whether someone has engaged in unconscionable conduct will usually turn on whether, taking account of all the circumstances of the case, that person has taken unacceptable advantage of, or exploited the ignorance or other vulnerability of, a person in a position of relative weakness to them. Depending on the circumstances, this might occur in the property advisory or wealth creation context. It should be noted that courts and other tribunals do not lightly find that someone has acted unconscionably, and that proving unconscionable conduct generally requires that a considerable amount of evidence be adduced and proven—a resource-intensive activity for government agencies.

As well as these general prohibitions, the general consumer protection laws contain measures designed to protect consumers from a range of more specific unacceptable marketplace practices including:

- false representations and other misleading or offensive conduct in relation to land;
- offering gifts and prizes without intending to provide them, or provide them as offered;
- referral selling;
- accepting payment without intending and/or being able to supply;
- harassment and coercion in connection with either the supply of goods and services or payment for them; and
- pyramid selling.

Some of these specific prohibitions may also be relevant in the property investment advice, promotion or wealth creation context.<sup>34</sup>

If established, breaches of most of the prohibitions in the general consumer protection laws constitute offences attracting fines. Breaches also give rise to a wide range of civil remedies, including declarations and injunctions, compensatory orders, orders prohibiting the transfer of money, and other orders. Although the laws in question are consumer protection laws, civil orders can be sought by private individuals, as well as by government agencies.

Substantiation notices are among the additional regulatory mechanisms available in some jurisdictions. These have been used, for instance by NSW, in connection with wealth creation operators.<sup>35</sup>

### 6.3 Real estate laws

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<sup>34</sup> Part 2B of the *Fair Trading Act 1999 (Victoria)* also contain potentially relevant provisions relating to the use of unfair terms in consumer contracts.

<sup>35</sup> See under NSW OFT, *Appendix A*.

The States' and Territories' real estate laws provide for the general regulation of the real estate industry and residential real estate transactions. In general terms, they establish a regulatory regime for vendors and owners rather than purchasers of real estate. The real estate laws cover a wide range of matters typically including: the licensing and general conduct of agents; agency agreements; the contract for sale; the conduct of auctions; agents' trust accounts and record keeping; compensation regimes where there is defalcation by an agent; and a range of other matters. There are significant variations in the regimes applying in the different State and Territory jurisdictions.

In the context of the current Paper, there are three critical points to note about the States and Territories' real estate regimes:

- the real estate regimes generally only apply to licensed real estate agents. So, they do not cover the activities of unlicensed property marketers. The one exception to this is the *Property Agents and Motor Dealers Act 2000 (Qld)*, which contains provisions applying to "marketeers".<sup>36</sup> This legislation is discussed further below; and
- the provisions of the real estate regimes generally only apply in respect of activities for which real estate agents are licensed. Typically, these activities are limited to activities related to buying, selling, exchanging and letting real estate. Thus, they do not generally cover—and are not intended to cover—advisory, marketing or education-providing activities.

In some of the State and Territory jurisdictions, however, there is a requirement that certain information be provided and warnings be given when financial or investment advice is provided by real estate agents.<sup>37</sup> Thus:

- persons to whom advice is given must be warned that the advice is general advice only, and that they should take steps to assess the suitability of any property investment in the light of their own needs and circumstances; and
- persons to whom advice is given must also receive information disclosing the existence and nature of any conflict of interest the agent may have in connection with the provision of advice (for example, entitlement to commission or referral fees).

We note that these provisions assume that real estate agents only provide general advice about property to prospective purchasers, as distinct from either more tailored or personalised advice or advice that is given outside the ordinary agent/buyer context.

Other aspects of the real estate legislation of the State and Territory jurisdictions that may be relevant to the regulation of property investment advisory, promotional and educational services include:

- *Disclosure of benefits and relationships*: Most jurisdictions have provisions related to the disclosure of commissions and other benefits and relationships with third parties to whom they refer their clients. Sellers' agents may also be required to make such disclosures to prospective buyers;
- *Obtaining a beneficial interest in property*: In most jurisdictions, an agent generally also commits an offence if they obtain a beneficial interest in a property they are selling; and

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<sup>36</sup> The Queensland legislation also imposes a licensing regime on certain property developers.

<sup>37</sup> See section 83, *Agents Act 2003 (ACT)*, section 46, *Property Stock and Business Agents Act 2002 (NSW)*.

- *Misrepresentations*: Each jurisdiction has provisions (varying in scope) related to the making of false or misleading representations. These provisions complement, but do not supercede, the general prohibitions of the general consumer protection laws discussed above.

Again, however, we note that these provisions only apply to the extent that the conduct in question relates to an activity for which the real estate agent is required to be licensed.

As noted above, the *Property Agents and Motor Dealers Act 2000 (Qld)* also contains property marketeering provisions. A marketeer, for the purposes of the *Act*, is broadly defined to include anyone directly or indirectly involved in any way in the sale or promotion of residential property, or the provision of a service in connection with a sale.<sup>38</sup> The marketeering provisions<sup>39</sup> (which are quite separate from the *Act's* licensing requirements) prohibit misleading conduct, unconscionable conduct, false representations and various forms of 'offensive' conduct by marketeers in relation to residential property in Queensland. A range of penalties and civil remedies are available.<sup>40</sup>

The marketeering provisions of the Queensland *Act* are modelled on and reflect the general consumer protection laws discussed above. However, they also provide additional guidance by including detailed reference to practices specifically associated with property marketing. They are expressed as not limiting the operation of any other laws. For details of regulatory action by Queensland pursuant to the marketeering provisions, see Appendix A.

#### 6.4 Credit laws

The regulation of consumer credit is primarily a State and Territory responsibility. ASIC also has general consumer protection powers in relation to credit as defined under the *ASIC Act*.<sup>41</sup> The States and Territories administer uniform consumer credit legislation under the *Uniform Consumer Credit Code [UCCC]*.

In the context of the current discussion, the *UCCC* will generally be of limited relevance. This is for two reasons:

- in essence, the *UCCC* is a product disclosure and credit sales regulatory regime. It does not seek to regulate advisory and related activities in relation to credit; and
- secondly, its application is limited to credit provided, or intended to be provided, 'wholly or predominately for personal, domestic or household purposes',<sup>42</sup> and these purposes are defined as excluding borrowing for investment purposes<sup>43</sup> (i.e., even where the purposes in question are personal, non-business investment purposes).

We note, however, that Consumer Affairs Victoria has recently taken action against a finance company that provided finance to persons attending seminars conducted by a property investment promoter for alleged breaches of the *UCCC*. In these circumstances, it is argued that the finance was not provided for investment purposes but to finance the provision of educational services.

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<sup>38</sup> Dictionary, Schedule 2, *Property Agents and Motor Dealers Act 2000 (Qld)*

<sup>39</sup> Chapter 17, *Property Agents and Motor Dealers Act 2000 (Qld)*

<sup>40</sup> Chapter 16, *Property Agents and Motor Dealers Act 2000 (Qld)*

<sup>41</sup> See under *Financial services laws* below

<sup>42</sup> Section 6(1)(b), *UCCC*

<sup>43</sup> Section 6(4), *UCCC*

## 6.5 Financial services laws

The regulation of financial services (apart from consumer credit) is primarily a Commonwealth responsibility, and ASIC is the Commonwealth agency that administers this area. It does so, principally, under two legislative regimes:

- Part 2, Division 2 of the *Australian Securities and Investments Commission Act 2001* [*ASIC Act*]. This regime replicates the general consumer protection laws discussed above in relation to financial services; and
- Chapter 7 (Financial Services and Markets) and Chapter 5C (Managed Investment Schemes) of the *Corporations Act 2001* [*CA*]. Chapter 7 is a comprehensive licensing, conduct and disclosure regime regulating services provided in relation to financial products, including financial product advice. For more information on this regime, see *Appendix B: How is financial product advice regulated?*

The financial services laws cover advice, dealing and a range of other activities or services in relation to 'financial products'. 'Financial products' are defined broadly and include: shares and debentures; derivatives; interests in managed investment schemes; life insurance contracts; general insurance contracts; interests in superannuation funds; Retirement Savings Accounts; debentures, stock, or bonds issued by a government; foreign exchange contracts; and deposit-taking facilities. While credit facilities are covered by the general consumer protection provisions of the *ASIC Act*, they are excluded from ASIC's licensing regime under Chapter 7, *Corporations Act*.<sup>44</sup>

Generally, the financial services laws have only limited relevance to property investment advice, and property-related promotional and wealth creation training activities. This is because of the way "making a financial investment" is defined in this legislation.<sup>45</sup>

Notwithstanding this, however, the ASIC legislation may apply in certain circumstances relevant to the property investment context. It will apply, for instance, where real estate-related conduct in some way also involves a financial product. This will obviously be the case where, as well as real estate, the promoter advises on, or deals in shares or managed investments etcetera as part of their seminar presentation or other activities.

Another situation where ASIC will have jurisdiction is where the property investment is structured as a managed investment scheme. ASIC has had general responsibility for the regulation of managed investments for a number of years and most interests in managed investments, whatever the nature of the investments involved, come within the ASIC legislation.

The ASIC legislation may also be applicable where returns from real estate are compared with returns from other asset classes. Whether this is the case, however, will depend on the

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<sup>44</sup> This reflects the fact that the regulation of consumer credit, at least, is primarily a State and Territory responsibility: see *Credit laws* above.

<sup>45</sup> See section 763B, *CA*, and section 12BAA(4), *ASIC Act*. The formal rationale for the exclusion of real estate is, broadly, as follows: With financial products (securities, derivatives, interests in superannuation funds and managed investment schemes, debentures, bonds etc) an investor surrenders day-to-day control of an amount of money or money's worth to another person who uses, or is intended to use, that money to generate a financial return for the investor. With direct investment in property, on the other hand, while the property itself may generate a return, it is not a return generated by the use of the investor's money by another person. Note that a distinction needs to be made here between *direct* investment in property and investment in a property trust or managed investment (where day-to-day control of the investor's funds is surrendered). The latter form of investment falls squarely within ASIC's jurisdiction.

circumstances in which the advice is given, the nature of the statements made, and the extent to which the adviser knows the investor's financial and investment circumstances. In addition, a loan by an investor to a company to fund a property investment may be a debenture and therefore a financial product. Again, however, this will depend on a range of circumstances. If a loan is not a debenture it is a credit facility and, while as such it will not be subject to ASIC's licensing jurisdiction under the *Corporations Act*, it will come within ASIC's general consumer protection jurisdiction under the *ASIC Act*.

*Appendix A* outlines regulatory action undertaken by ASIC pursuant to the above-mentioned legislation.

## **6.6 Concluding comments**

In this section we have referred to a number of examples of regulatory action by State and Commonwealth agencies. As previously indicated, these activities are further described in *Appendix A*. *Appendix A* also describes surveillance and consumer education initiatives undertaken by agencies. Obviously, the extent of action by particular agencies will depend in part on their size, as well as the extent of concerns within their respective jurisdictions.

As the outlines above indicate, apart from the general consumer protection laws, the various laws considered will generally have only limited application to the subject area of this review. In consequence, in the sections that follow—in which the issue of regulatory reform is dealt with—we will largely focus on whether the general consumer protection laws adequately deal with the perceived problems.

### **Question 8**

Do you have any comments on our outline of the current legal framework? Apart from those we have considered, are there any other laws or regulatory mechanisms relevant to the regulation of property investment advice and training activities?

## **7. Objectives of Government intervention and the current legal framework**

### **7.1 What are the objectives of Government in relation to property investment advice?**

The objectives of government intervention in relation to the property investment advice market are to ensure:

- that the market is transparent and operates consistently with community standards and expectations;
- that advisory services to retail investors and prospective investors are of a generally high standard; and
- that the market promotes informed retail investor decision-making, and ultimately that it enhances returns for investors.

To take the first of these objectives, we consider that transparency and consistency with general community standards and expectations assumes a market in which:

- participants are competent to provide the services they provide;
- participants act honestly, according to the standards of ordinary people;
- advice is something more than disguised sales promotion or marketing;
- consumers and investors are not ‘ripped off’; and
- vulnerable consumers are not exploited.

To take the second of these objectives, we consider that, to be of a high standard, property investment advice:

- should not be conflicted. At very least, all conflicts or potential conflicts of interest should be adequately disclosed;
- should include a balanced assessment of the down-side risks associated with any proposed investment strategy; and
- should have a reasonable basis taking account of the investor’s financial situation and objectives or needs, on the one hand, and the proposed investment or type of investment, on the other. As a minimum, if the individual circumstances of the investor are not taken into account, this must be acknowledged and the limitations of the advice noted.

The third of the objectives is self-explanatory. A market for advisory services that does not deliver, in aggregate terms, better returns for investors than would be the case if such services were not provided cannot be regarded as acceptable, in our view.

You may consider that some or all of the objectives outlined in this sub-section are inappropriate, or that government should have other objectives as well. If so, Question 9 provides you with an opportunity to indicate your views and the reasons for them.

### **7.2 Are Government objectives currently being met?**

The Working Party considers that the objectives referred to in the previous paragraphs may not currently be being met. The information set out in sections 4 and 5 above suggests that:

- practices at variance with community standards and expectations are quite widespread; and

- the standard of advice provided by property promoters frequently falls well short of what might be considered appropriate.

These views are further supported by the widespread concern expressed about the operation of the property investment market by industry and consumer stakeholders, financial commentators, and in editorials in major newspapers.

It is also doubtful whether retail investor decision-making, and ultimately investor' returns, have been enhanced overall by the activities of property investment promoters. Indeed, the opposite may have been the case. As section 3 seeks to demonstrate, there appears to have been an excessive level of speculative investment, particularly in inner city investment units in recent years, and many investors are likely to be 'burned' as a result of poor investment decisions. The aggressive marketing of housing investment by seminar operators and other promoters under the guise of wealth creation advice has clearly contributed to this speculative environment.

### **7.3 Are Government objectives achievable within the current regulatory framework?**

The Working Party also considers that the objectives referred to above may not be able to be achieved within the current regulatory framework.

The general consumer protection laws can undoubtedly be used to moderate some forms of conduct that are not consistent with community standards and expectations. Recent action by regulators using these laws (see *Appendix A*) does appear to have led to a reduction in the level of property spruiking activities—although the general cooling of the investment market also needs to be considered in this context.

On the other hand, the general consumer protection laws only allow action to be taken after misconduct has occurred; they do not impose any significant barriers to entry into, or participation in, the advisory market by rogue traders and other marginal and/or incompetent operators. Nor do these laws really address the objective of ensuring that investors generally receive a good standard of advice about property investment.

More specifically, under the general consumer protection laws, there are:

- no minimum training or education qualifications or fitness and propriety requirements;
- no requirement that the consumer's circumstances be assessed to ensure the suitability of an investment proposal, financing arrangement or education product/service;
- no requirement to undertake other research to ensure that recommendations have a reasonable basis;
- no requirement to provide documentary evidence of the advice given; and
- no requirement to avoid or declare conflicts of interest.

In the absence of at least some of these requirements, it is arguably unclear how quality of advice issues can be addressed.

Problems relating to quality of advice are also likely to be exacerbated where there is inadequate disclosure. As we have seen, the general consumer protection laws prohibit misleading or deceptive conduct and false or misleading representations, and other false

representations.<sup>46</sup> On the other hand, they generally do not impose positive obligations to disclose information unless that information is needed to correct a representation likely to mislead or deceive.<sup>47</sup> Thus, generally there are:

- no fee and commission disclosure requirements;
- no requirements to disclose associations and relationships that may influence the adviser;
- no obligations to disclose the reasons for making a particular recommendation; and
- no obligation to provide a written record setting out this information.

Nor would there appear to be any incentives for market participants to disclose this information on a voluntary basis. In other words, it is only through government intervention that such disclosure is likely to occur.

Finally, there also are considerable evidential and resource issues associated with reliance on general consumer protection laws. Unconscionable conduct-based litigation, in particular, is very resource-intensive and few cases have been undertaken. In the case of misleading conduct, and false and misleading representations, too, it can be difficult to establish misconduct, especially where the representations relate to future movements in property values or where there is any ambiguity about the falsity of claims made. These difficulties may limit the potential of the general consumer protection laws to deter rogues and unscrupulous operators.

#### **7.4 Concluding comments**

It would appear that the objectives of government in the property investment advice area are not being met, and may not be able to be met, within the current regulatory framework. Given this, what options for reform are available to government?

In section 9, we consider a number of options, and the costs and benefits for different stakeholders of each. Options include:

- retaining the status quo—even if the above analysis is correct, retaining the regulatory status quo may still be the appropriate response. This would be the case if the costs for stakeholders associated with implementing a new regime were calculated to be in excess of the likely benefits to be derived from such a regime. If this were found to be the case, improved market outcomes may still be able to be achieved by making better use of the existing regulatory tools, as well as other strategies such as consumer/investor education;
- additional self-regulatory initiatives;
- limited law reform, for instance additional conduct and disclosure requirements; and
- a comprehensive conduct, disclosure and licensing regime applying to property investment advice.

Before looking at these Options in more detail, however, we need to examine more precisely what it is we are seeking to regulate. This preliminary examination is necessary because our analysis of the costs and benefits of the different Options noted depends in part on how we define the regulatory 'territory' under consideration.

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<sup>46</sup> *ibid*

<sup>47</sup> In some circumstances, the failure to provide information may be found to constitute a breach of the misleading or deceptive conduct prohibition of the general consumer protection laws.

**Question 9**

Do you agree with the stated objectives of government intervention in the property investment advice market place? If not, what should government's objectives be?

**Question 10**

Are the objectives referred to in the previous question currently being met?

**Question 11**

Can the objectives of government in relation to property investment advice be realised to an acceptable level within the current regulatory framework?

## **8. The scope or coverage of regulation**

### **8.1 Introduction**

Because of the breadth of the general consumer protection laws, the issue of the scope or coverage of retail property investment advice under these laws does not arise. However, if it were decided to introduce additional sector-specific regulation of property investment advice, a number of 'threshold' issues going to the scope or coverage of that regulation would need to be resolved.

These include:

- who would be protected by any new regime;
- what activities would it seek to cover;
- what would be encompassed by "property" for the purposes of the regime; and
- whether there should be any "carve outs" from the regime.

Without seeking to prejudice the issue of whether there *should* be additional regulation of the property investment area—this is considered in section 9—we address these threshold issues in this section.

### **8.2 Who would be protected by any new regime?**

The Working Party considers that, if a new regulatory regime were introduced, it should not extend to wholesale, institutional or professional investors, but should be limited to retail investors (including small businesses) and consumers. As with the financial services laws, the Working Party believes that a property-specific retail/wholesale test would need to be developed if a new scheme were to be introduced.

### **8.3 The regulated activities**

In our view, a functionally-based approach to regulation would be the appropriate one in this area—rather than, say, an occupation-based approach or one based on form (for instance, a regime that attempted to regulate property seminars or workshops only). In other words, those who engage in the regulated activities should be subject to any new regime, however they are described and whatever the format of their activities (subject to any "carve outs": see below). We think this is the only sensible approach, given the range of individuals and businesses currently involved in property investment, and the various ways in which investment advice is packaged and presented.<sup>48</sup> A narrower approach would be likely to encourage regulatory arbitrage—where rogue and marginal traders simply redefine their activities to avoid the regulatory scheme. In addition, a functional approach would be consistent with the financial services laws which adopt such an approach: see *Appendix B*.

We also think the activities covered should include advice about the financing of property investment. Financing arrangements are typically integral to the whole investment transaction and, as we have seen, many of the consumer/investor problems relate to the way investment finance is promoted.

Secondly, were a new scheme to be introduced, the activities encompassed should be focused on advice that is intended to *prompt action* by investors and consumers. Thus, we

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<sup>48</sup> See paras. 4.3 to 4.8 above

consider that the activities encompassed by any new regime should include, generally, recommendations, statements of opinion and reports that are either intended to, or could reasonably be regarded as being intended to, influence someone in making a decision about a property investment.

Our objective here would be to give the idea of "advice" a wide scope, and to include both:

- personal or 'tailored' advice (advice that takes account, or purports to take account, of a consumer/investor's financial objectives, situation and needs etcetera); as well as
- more general advice (such as might be given to a seminar audience, for instance).

Again this approach parallels that of the financial services' laws: see *Appendix B*.

It may be argued that a problem with this approach to defining "advice" is that, notwithstanding its breadth, it would still not be broad enough to encompass some activities of property marketers that have been a cause for concern—for instance, training materials and perhaps seminar presentations that studiously avoided making any recommendations or offering statements of opinions etcetera.

We agree that this is a risk; however, we would not want any regime that might be proposed to encompass too much either—for instance, we do not think it desirable for a new regime to cover mere information provision, such as a university lecture on investment financing, say, or a consumer advice column in a newspaper. Any views you may have on this aspect of the 'scope' issue would be welcome.

#### **8.4 What "property" would be covered?**

To date, retail investors have generally focused on residential property. However, this has not been universally the case.<sup>49</sup> The Working Party considers that any new regulatory scheme should cover investment advice to retail investors about any form of real property, not just residential property. We consider this to be advisable in the interests of regulatory parity, and, as an aspect of this, because we think that, if advice about commercial, retail and industrial property were not also 'caught', rogue and marginal operators may move into these less regulated areas.

#### **8.5 Regulatory carve-outs?**

A new regulatory scheme would potentially have the consequence of making some market participants subject to dual regulation—both an existing regulatory scheme which applies to some of their current activities and the new scheme. A case in point is real estate agents.

As we noted above, real estate agents give at least general advice to prospective buyers (and sometimes sellers) as part of their regular services. These advisory activities would be caught by a functionally-based regime applying to all investment advice about property. At the

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<sup>49</sup> For instance, in the WA finance brokers scandal of the 1990s, retail investors were encouraged to invest in retail shopping centre developments.

same time, many activities of real estate agents are already subject to detailed requirements including licensing under the real estate laws, and these obligations would obviously continue to apply as well.

It should be noted that the issue of dual regulation of real estate agents would arise whether a new regulatory scheme were administered by the Commonwealth or the States and Territories.<sup>50</sup> Thus, if the Commonwealth were to assume responsibility for investment advice about property, the advisory activities of real estate agents would come under the Commonwealth's jurisdiction, while other aspects of the activities of agents would come within the State and Territory laws, as at present. Similarly, if the States and Territories developed the new regime, it is unlikely that this could be achieved within the context of the current real estate laws. For one thing, the advisory activities of unlicensed property investment advisers—whose activities have been of primary concern in recent years—would not be caught by a regime that only applied to licensed agents. Again, in other words, there would be a need for dual regulation.

Arguably, however, dual regulation may have the potential to be quite onerous, particularly for small business operators (as most real estate agencies are). This raises the question of whether a “carve-out” for real estate agents from any new scheme would be justified and, if so, on what terms.

For instance, if there were to be a carve-out, should it apply to *any* advisory activities of real estate agents? Or should it apply more narrowly, as the Working Party is inclined to think. For instance, should a carve-out just apply to general advice given to a prospective purchaser in the context of the agent's ordinary activities as a real estate agent?

Moreover, in this eventuality, what measures ought to be adopted to ensure that the standard of general investment advice given by real estate agents is broadly comparable with that provided for by the new regime. Would it be appropriate, for instance, to introduce certain requirements into the real estate laws, as a 1999-2000 ASIC report on property investment advisory activities of real estate agents recommended?<sup>51</sup> Or would some other mechanism, for instance an industry code, be effective?

Apart from real estate agents, the issues of dual regulation may also arise in relation to some other groups of property investment advisers, such as those currently licensed under the financial services' licensing regime. As we have seen, property investment advice is not generally 'captured' by this regime and the other requirements of the financial services laws.<sup>52</sup>

## Question 12

If a new regulatory scheme were to be introduced, what should its scope or coverage be?

<sup>50</sup> The question of who should regulate is discussed in section 10.

<sup>51</sup> The ASIC review which led to the report was prompted by a Recommendation of the Final Report of the Financial System Inquiry (“the Wallis Report”) calling for a separate review of existing regulation of the provision of investment advice by real estate agents. In response, the Federal Government tasked ASIC to conduct the review. For a summary of the Report, see ASIC Media Release 00/064 (13-19 February 2000) *ASIC completes review on real estate agents* available at [www.asic.gov.au](http://www.asic.gov.au) (search under media releases)

<sup>52</sup> See para. 6.20 above

What activities should be covered, in respect of what types of property, and who should be protected? Do you agree that related advice about the financing of property investment should be covered in any new scheme?

**Question 13**

If a new regulatory scheme were to be introduced, would a "carve out" from that scheme be justified for any particular professional or trade groups, or in respect of any particular activities? If so, why and on what terms?

## **9. Reform options and their impact**

### **9.1 Introduction**

In this section we outline three broad Options for regulatory reform, including retention of the status quo, and provide our analysis of the likely regulatory impacts of each. This involves briefly identifying the likely benefits and/or likely costs of each Option for:

- consumers/ retail investors;
- industry; and
- government.

Question 16 seeks your views as to which of these Options should be preferred.

Within this framework, where necessary, we also identify differences between the likely impacts for different industry groups or sectors, as well as, where applicable, differences in the impacts for State and Territory governments, on the one hand, and the Commonwealth and its agencies on the other. (The issue of whether, in the event that there were to be regulatory reform, a new regime should be the primary responsibility of the States and Territories or the Commonwealth is further considered in section 10.)

The Options considered (apart from *Retain the status quo*) could have been further broken down into a number of more specific Options involving different levels of regulation short of licensing, and different levels or types of licensing. However, we believe the current format allows the key regulatory impact issues to be adequately addressed. We have also separately sought your views on what specific regulatory requirements or mechanisms should/ should not be introduced in the event that a new regime was to be established: see Question 15.

Our analysis in this section assumes your familiarity with the discussion of scope or coverage issues in section 8.

### **9.2 Reform Options**

#### *Retain the status quo [Option 1]*

Supporting this Option means you think we should continue to rely primarily on the general consumer protection laws (outlined in section 6) to regulate investment advice about property. Conduct prohibited under the general consumer protection laws includes misleading and deceptive conduct, false or misleading representations and unconscionable conduct. The credit laws and the financial services laws (also outlined in section 6) may also be relevant in limited circumstances.

You might support retention of the status quo for one or more of a number of reasons:

- you consider that the market is currently operating efficiently and that problems identified in sections 4 and 5 are not significant, or not at odds with community standards and expectations;
- you consider that there are significant problems but that these are being adequately addressed within the current regulatory framework and through various consumer education initiatives of government (outlined in *Appendix A*);
- you consider that the response of governments to date has not been adequate, but that the issue is not the regulatory framework itself but a lack of willingness, and/or

resources, on the part of government to take adequate pro-active action. There have been public comments along these lines; and

- finally, you consider the current framework is not adequate, or probably not adequate, but that the benefits likely to accrue from a new regulatory scheme would be outweighed by the costs.

The costs and benefits of retaining the status quo, as against adopting a new scheme, are considered further below.

### *Self-regulatory and co-regulatory options*

This option would cover such measures as:

- a voluntary code of conduct developed and administered by industry in consultation with other stakeholders; and
- a mandatory code which those who provide property investment advice are required to comply with, but which is developed and administered collaboratively by industry, government and consumer stakeholders.

The Working Party does not consider that the full range of activities and individuals engaged in property investment advice can be encompassed by a self-regulatory or co-regulatory regime. As we have already noted in part:

- property investment advice cuts across various industry sectors and professional and trade groups<sup>53</sup>;
- many property investment promoters do not belong to any readily defined sector or institutionalised grouping<sup>54</sup>;
- there is no industry association representing the range of participants in the property investment advice market that could develop/help develop and administer a code or similar instrument;
- there are few barriers to entry into this area of activity and a proportion of promoters, at least, appear to be 'fly-by-night' operators without significant or long-term reputational interests to secure or protect; and, *related to this*
- considerable concerns have been raised about the business practices and ethics of a significant proportion of property investment operators.<sup>55</sup>

Given these circumstances, self-regulatory and co-regulatory mechanisms do not appear viable to us and are not further discussed among the Options considered below. However, Question 14 invites you to make submissions regarding the role of these mechanisms if, notwithstanding our views, you consider these to be potentially relevant in the context of property investment advice.<sup>56</sup>

### *Additional requirements short of a full licensing regime [Option 2]*

Supporting this position means you think that there is a need for legislative reform, for instance to enhance conduct and disclosure requirements applying to those who give

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<sup>53</sup> See section 4 above

<sup>54</sup> *ibid*

<sup>55</sup> See sections 4 and 5 above.

<sup>56</sup> There may also be some potential for self-regulatory initiatives, or further initiatives, on the part of particular industry groups (for example, real estate agents) in relation to those of their members involved in the activities under consideration.

property investment advice; however, you do not consider a comprehensive licensing regime covering, for instance, training and competency requirements to be necessary.

Some of the specific measures imposed in relation to investment advice about financial products (see *Appendix B*) might be considered in the context of this Option. This may include the following:

- similar disclosure obligations to those imposed on financial product advisers as detailed in *Appendix B*, including the specific obligations if personal advice is provided;
- up-front disclosures of conflicts of interest, commissions, fees and charges, contents of property investment courses, further recommended courses and associated fees and charges;
- cooling-off periods – this could be a general right to cool-off to cover all variables relating to property investment advice, including the payments for seminars (initial and up-selling to further seminars), other products such as videos, books and other goods and services, extended to any agreements that require financial commitment;
- an obligation could be imposed on property investment advisers to warn consumers of any risks associated with the property investment advice that is provided;
- a general obligation to act efficiently, honestly and fairly, as detailed in *Appendix B in relation to financial services*;
- a penalty for exclusionary clauses could be introduced – for example at some seminars consumers are required to sign a disclaimer before entering seminars agreeing to absolve the property investment adviser from any legal liability;
- anti-hawking provisions – as detailed in *Appendix B* for financial services; and
- the obligation on the adviser to have an internal dispute resolution system in place.

You may wish to suggest other mechanisms as well. As with the *Status quo* position, costs and benefits associated with this intermediary position are considered further below.

#### *Comprehensive conduct, disclosure and licensing regime [Option 3]*

You would support this Option if you considered comprehensive licensing, conduct and disclosure of property investment advisory activities to be necessary. The financial services regime (see *Appendix B*) provides an obvious model for a ‘high intensity’ regime, and you may consider most or all the requirements of that regime also to be appropriate in the property investment context. Alternatively, you may think that only some of the *Corporations Act* licensing regime requirements are appropriate to the property investment context, or that other measures should also be considered. Again, the costs and benefits of this model are considered further below.

### **9.3 Option 1: Retain the status quo—benefits and costs**

The main benefit of retaining the status quo would appear to be the avoidance of compliance costs for industry and administrative costs for government associated with establishing and maintaining/administering a new regulatory regime. There may also be some indirect

benefit to consumers in that additional compliance costs that might otherwise be passed on to consumers would not be passed on.

Some people may also consider that increased regulation could lead to a reduction in the flexibility with which services are delivered, and/or the ability of new participants to enter the market and maintain/enhance competitive pressures. What weight you put on such considerations will depend in part on your assessment of the nature of the services currently being provided. Few people want to see incompetent or rogue traders having easy market entry or operating 'flexibly' in the advisory market. On the other hand, any additional regulation would impact on well-conducted businesses as well as sharp operators.

The main cost associated with retaining the status quo would appear to be the costs to consumers/investors associated with poor quality and conflicted advice leading to:

- the purchase of inappropriate and/or over-priced training services and products; and
- poor decisions about property investments resulting in poor returns on investments and, in some cases, financial disaster (including loss of the family home, bankruptcy etcetera).

The potential for negative outcomes for consumers/investors under the current arrangements would appear to be considerable. In this context we note:

- the widespread attraction of real estate as an investment, including for less sophisticated investors<sup>57</sup>;
- the apparent under-recognition of the risks associated with property investment within the community<sup>58</sup>;
- the extent of the financial commitment involved in the purchase of a property<sup>59</sup>; and
- the potential vulnerability of many middle-aged, middle income Australians who, not having had the benefit of life-long superannuation, are concerned about their capacity to fund a reasonable retirement lifestyle. As we have noted, the promotional activities of some marketers exploit the legitimate anxieties about financial security of this group.

The disparity between the regulation of investment advice about property and investment advice about financial products is also relevant in this context. As we have seen in section 6, while the former is subject to the general consumer protection laws only for the most part, the latter is comprehensively regulated under the *Corporations Act* (see paragraphs 6.18 to 6.24 above and *Appendix B*). This lack of regulatory parity has a number of implications.

For one, there is evidence that rogue traders have been attracted to property investment promotion (as well as mortgage broking) from other areas of financial services that are, or have become, more highly regulated. The recent property boom and associated consumer interest in property has brought rogues into the market, and the regulatory framework has posed few barriers to their entry.

Secondly, the lack of regulatory parity increases the risk of consumer confusion about the level of supervision of the property investment area by government. Notwithstanding the

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<sup>57</sup> See paras. 3.16-3.23 above

<sup>58</sup> *ibid*

<sup>59</sup> As the Productivity Commission recently noted: "*Given the magnitude of the commitment involved in buying a house, the consequences for individuals of imprudent lending, or poor purchasing decisions made on the basis of misleading information, can be very serious*": p.46, *First Home Ownership: Discussion Draft* (op. cit.)

very different levels of regulation, there are clearly functional similarities between giving investment advice about property and giving investment advice about financial products (securities, term deposits, government bonds etcetera). For one thing, the considerations that prompt investors to acquire, hold, or sell investments in each case are frequently similar. Moreover, most people regard these as interchangeable investment alternatives.<sup>60</sup>

Given this functional similarity, there is a risk of consumers/investors believing the level of regulatory control and supervision to be similar in each case. Most consumers are unlikely to have a sophisticated understanding of jurisdictional demarcations and limitations affecting one set of advisers but not another.<sup>61</sup> They may therefore make property investment decisions influenced by a view of the level of regulatory supervision that is not justified in relation to this class of investment.

Apart from consumers/investors, there would also appear to be costs for some investment advisory businesses associated with the regulatory disparity we have been considering. In particular, in recent years financial planning businesses, stock brokers and others (including many smaller businesses) have met with significant additional compliance costs associated with obtaining and maintaining an ASF licence and other requirements of the post-*Financial Services Reform* regime.<sup>62</sup> Arguably, because comparable costs and conduct requirements are not imposed on their competitors in the property investment area, AFS licensees are placed at a competitive disadvantage—a level playing field does not exist.

From a macro-economic perspective, too, there would appear to be costs associated with retaining the regulatory status quo. Under the current arrangements, the market may be promoting rather than mitigating the information asymmetry between consumers/ investors and the property industry. As a result, as was suggested in section 3, available investment funds may not be being allocated efficiently—as some economists would argue, too much investment money may be going into speculative home unit development. In addition, human and other resources (professional services, entrepreneurial skills etcetera) may be being diverted from more productive activities.

If this is happening, it is arguably undesirable from a general economic, as well as an individual investor, perspective. In this context, we note that the Reserve Bank of Australia has referred, on more than one occasion, to the activities of property investment promoters as having contributed to an overheated property market, and as requiring further regulation.<sup>63</sup> The recent *Productivity Commission First Home Ownership Discussion Draft* contains some somewhat similar remarks.<sup>64</sup>

Finally, to the extent that the market is fostering poor investment decisions by, in particular, mid-life households it may also limit the capacity of these households to generate retirement

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<sup>60</sup> Discussed in 1999-2000 ASIC report on property investment advisory activities of real estate agents: see footnote 50 above.

<sup>61</sup> Footnote 45 details the regulatory jurisdiction and the distinction between property and financial products investment.

<sup>62</sup> See *Appendix B*

<sup>63</sup> Ch 3.3, *Productivity Commission Inquiry on First Home Ownership: Submission by Reserve Bank of Australia*. See also 3.33, *Review of the Reserve Bank of Australia Annual Report 2003 – Interim Report*, House of Representatives Standing Committee on Economics, Finance and Public Administration (March 2004, Canberra)

<sup>64</sup> The *First Home Ownership: Productivity Commission Discussion Draft* (December 2003) refers to “aggressive marketing of housing investment ‘opportunities’” (p. XVI) and indicates a generally supportive attitude to reform (see pp.45-46)

income from investments, contrary to the Commonwealth Government's retirement incomes policy.

#### **9.4 Option 2: Additional requirements short of a full licensing regime – benefits and costs**

The above-mentioned costs to consumers/investors of retaining the status quo would be reduced, under this Option, to the extent that additional measures introduced targeted the market place problems effectively. Measures to require disclosure of commissions and benefits, and relationships and associations, may encourage consumers/investors to be more circumspect about the advice they receive. On the other hand, a disclosure regime alone would not address issues going to the quality of advice given by property promoters.

Roughly speaking, the cost of additional regulation to industry (in initial and ongoing compliance costs) and government (in developing and administering the regime) is likely to be proportional to the degree of regulatory intensity of the regime. The more detailed and prescriptive the regime is, generally the higher the costs associated with it will be. (On the other hand, the benefits in terms of consumer protection are also likely to be proportionately greater where the regime is more prescriptive.) Under Option 2, there would be additional costs associated with regulation for both industry and government. For example, industry may have to alter its conduct so that it was in accordance with the conduct requirements of the legislation and there may be consequential administrative costs. Property investment advisers and new entrants would incur upfront costs in learning about the requirements, training staff, developing systems, setting up internal complaints handling procedures and the ongoing costs of preparing statements of advice. However, these would be significantly less considerable than if a licensing regime incorporating training and competency requirements were to be introduced: see Option 3.

Some additional costs may also be passed on to consumers if this Option were adopted. On the other hand, the variability of pricing for advisory services, and the very high prices that some operators are currently able to charge, must cast doubt on the extent to which pricing is actually constrained by promoters' costs at present.

#### **9.5 Option 3: Comprehensive conduct, disclosure and licensing regime—benefits and costs**

The capacity of regulation to address quality of advice/ competency of adviser issues outside the framework of a licensing regime that specifies training standards or qualifications is arguably generally limited, especially where self-regulatory options are not available. In addition, while positive disclosure obligations, and more specific obligations in relation to conduct, redress mechanisms etcetera need not require that persons to whom they apply be subject to a licensing regime, licensing may assist in ensuring compliance with these other obligations. A licensing regime also imposes significant barriers to entry and ongoing participation in the market by entities that may lack the resources to provide adequate services. It is also likely to discourage 'fly-by-night' rogue traders to a significant extent.

In short, from a consumer/investor perspective, a comprehensive regime is more likely to be effective in reducing consumer detriment resulting from misconduct and poor quality advice than are the alternative Options.

In addition, we have suggested that there are a number of disadvantages (both for consumers and for some industry participants) with the current lack of parity between the level of

regulation required for financial product advice and the level required for advice about property investment.

On the other hand, a comprehensive regime would obviously impose significant additional compliance costs on the property investment industry as a whole, including well-conducted small businesses. Depending on how the "carve out" issues discussed in section 8 were resolved, it may expose some advisory businesses, and potentially real estate agents, to dual licensing regimes.

From an industry perspective, these considerations would need to be balanced against the potential benefits, in terms of industry reputation and consumer confidence, that a more rigorous regulatory regime may bring.

From a consumer perspective, in theory at least, the benefits of higher standards of conduct would come at the cost of higher prices and reduced consumer choice. On the other hand, as we have already noted, the extent of price competition in the market at present is a matter of debate. Moreover, reduced consumer choice will only be of concern to the extent that increased costs drive competent, reputable operators out of the market or make it more difficult for them to enter. Potential consumer detriments associated with greater regulation also need to be balanced against the potentially high costs for those consumers who make decisions based on poor or inappropriate advice.

## 9.6 Summary of cost/benefit analysis of options

### Option One: Retain the Status Quo

|                 | <b>Benefits</b>  | <b>Costs</b>  |
|-----------------|--|---|
| <b>Consumer</b> | <p>Consumers/ investors enjoy protection to degree afforded by current regime</p> <p>No additional regulatory costs passed on to consumers</p> | <p>Consumer protection issues associated with quality of advice, disclosure, accountability and redress etcetera not effectively addressed</p> <p>Few barriers to entry/participation by rogue traders and incompetent advisers</p> <p>Ongoing potential for consumer/investor detriment, including possibility of considerable detrimental impact on the retirement incomes of some</p>  |
| <b>Industry</b> | <p>No additional compliance costs</p>  | <p>Consumer confidence in property investment advice industry difficult to establish/ maintain/ enhance.</p> <p>Well-conducted businesses suffer reputation damage by association</p> <p>Lack of regulatory consistency/ neutrality with advisory businesses required to hold an AFS licence and subject to financial services laws</p>   |
| <b>Gov'ment</b> | <p>No additional administrative costs</p>  | <p>Ongoing criticism of perceived failure to protect consumers/ investors as detrimental impacts continue. This cost is likely to be borne primarily by the Commonwealth agencies</p> <p>Ongoing dependence on costly and uncertain litigation based on general consumer protection laws unsupported by administrative controls and remedies</p> <p>Ongoing economic distortion associated with diversion of investment funds into speculative property investment</p> <p>Potentially negative impact on Commonwealth's retirement incomes policy to the extent that unresolved market problems result in poor investment decisions</p> |

### Option Two: Limited additional requirements introduced short of full licensing regime

|                  | <b>Benefits</b>  | <b>Costs</b>   |
|------------------|--|--|
| <b>Consumer</b>  | <p>Likely costs to consumers of retaining status quo reduced to the extent additional measures target problems effectively</p> <p>Measures are likely to enhance disclosure of commissions and benefits, relationships and associations. This may encourage more critical and circumspect consumer/investor attitudes</p> <p>May result in some improvement in investor/consumer decision-making leading to better returns on investments over longer term</p> | <p>Measures may not be effective especially in targeting quality of advice/ competency issues</p> <p>May not act as a sufficient disincentive to rogue operators and incompetent advisers</p> <p>Additional costs associated with increased regulation are passed on to consumers.</p> |
| <b>Industry</b>  | <p>May discourage rogue traders leading to some improvement in industry image and consumer/investor confidence</p> <p>Would increase regulatory parity for AFS licence-holder; but disparity would still remain</p>  | <p>Additional compliance costs, but less than under Option 3</p>   |
| <b>Gov'tment</b> | <p>Would provide additional regulatory tools for use in controlling rogue and marginal operators</p> <p>If market conduct improves and consumer detriment reduces, may lead to reduced dissatisfaction with government responses</p> <p>Improved investment decision-making may lead to better allocation of investment funds thereby benefiting economy generally and position of retirees/ future retirees</p>   | <p>Additional measures may not be sufficient to control competency/ quality of advice, in particular</p> <p>Rogue operators and incompetent advisers may not be able to be controlled effectively</p> <p>Some additional administrative costs</p>                                      |

**Option Three: Comprehensive conduct, disclosure and licensing regime**

|                 | <b>Benefits</b>           | <b>Costs</b>                       |
|-----------------|---------------------------|------------------------------------|
| <b>Consumer</b> | Should drive considerable | Some elements of regime may add to |

|                  |  |  |
|------------------|--|--|
|                  | <p>improvement in standards of advice about property investment over longer term; thereby resulting in aggregate improvement in quality of investor decision-making and ultimately investor returns</p> <p>Would significantly raise entry and participation costs for rogue and marginal operators. Likely to reduce activities of fly-by-night operators considerably, if effectively enforced</p> | <p>costs passed on to consumers/investors, and/or reduce flexibility of services, without delivering significant additional benefits</p> <p>Unfair and detrimental conduct may still occur, albeit to a reduced extent</p> <p>Regulation of advisory activities may not catch some high pressure and/or exploitative activities able to be characterised as ‘information’ or ‘education’ only</p>                      |
| <b>Industry</b>  | <p>Should help create positive environment for development of mature property investment advisory sector</p> <p>Depending on coverage of regime and/or carve-out parity requirements, should remove regulatory disparities between different types of advisory businesses</p>  | <p>Likely to significantly raise costs of participation in regulated activities for property investment advisory businesses, including well-conducted small businesses</p> <p>Depending on resolution of regulatory issues, may expose some businesses to possibility of dual licensing</p>  |
| <b>Gov’tment</b> | <p>Likely to provide governments with significant additional tools for controlling rogue traders and incompetent advisers</p>  | <p>Use of regulatory mechanisms by government subject to resource constraints</p> <p>Significant establishment and ongoing administration costs. These costs would be incurred by either the Commonwealth or the States and Territories, depending on which had regulatory responsibility. Costs may be greater for States and Territories as they would include jurisdictional coordination costs: see section 10</p> |

**Question 14**

Is there a role for self-regulatory or co-regulatory mechanisms in the regulation of property investment advice?

**Question 15**

If a new regulatory scheme were to be introduced, how detailed and prescriptive should the scheme be? Are there particular regulatory requirements or mechanisms that should/ should not be introduced?

**Question 16**

What is your preferred Option among those outlined in this section? Why? Are there other or variant Options that we should consider?

## **10. A States and Territories' or a Commonwealth responsibility?**

### **10.1 Introduction**

The question of whether a property investment advice regime should be administered by the States and Territories or by the Commonwealth (through ASIC) is considered in this section. We briefly outline views supportive of each alternative. As the issue of *who* should regulate is closely linked to the issue of whether any legislative reform should take the form of stand-alone legislation, or be incorporated within an existing regime, we also consider this issue in this section.

### **10.2 Regulation by the States and Territories**

The direct regulation of the real estate industry is a traditional role of States and Territories, and there may be advantages in seeking to regulate investment advice about property at the State and Territory level because of this. For instance:

- if the Commonwealth was to regulate part of the property industry, and the States and Territories continued to regulate another part (real estate agents), issues associated with dual and potentially inconsistent regulation may arise. For instance, advice given by real estate agents may be regulated inconsistently with similar advice given by persons subject to a Commonwealth regulatory regime; and
- if the *Corporations Act 2001* and the *ASIC Act 2001* definitions of a 'financial product' were extended to include real estate (as part of arrangements to bring real estate investment advice within the existing financial services laws), ASIC's jurisdiction may thereby be extended into areas of general regulation of real estate-related activity that would be regarded as inappropriate for a regulator of financial services.<sup>65</sup>

On the other hand, there would be difficulties associated with State and Territory regulation as well. These relate in part to the question of what form regulation would take, and the resources associated with the development and implementation of an effective regime.

To be effective, in the Working Party's view, a State and Territory regime would need to take the form of stand-alone legislation that is either generally consistent or uniform across the State and Territory jurisdictions. As a preliminary point, we do not consider incorporation of a new scheme within existing State and Territory real estate laws to be an option. Persons providing property investment advice are certainly not limited to real estate agents. Further, the State and Territory real estate regimes are unique to each jurisdiction and implementation of reform would therefore require a discrete approach in each jurisdiction.

More generally, consistent or uniform State and Territory legislation would be highly desirable, in our view, given that traders operating in the property investment advice field do

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<sup>65</sup> See paragraphs 8.12 to 8.18 above in relation to these concerns.

so across State and Territory boundaries. Significant differences in the regimes of individual jurisdictions would be likely to create loopholes for potential exploitation by unethical traders. Issues of the extent of each jurisdiction's responsibility would also need to be addressed as, again, any confusion regarding which State or Territory exercised jurisdiction in relation to particular transactions would be likely to be exploited by rogue and other marginal operators.

A further issue would be the administration of any consistent or uniform State and Territory regime. An effective nationwide compliance management program would be needed. This would require significant coordination and cooperation by jurisdictions and would impose additional regulatory costs. Coordination would be further complicated by the fact that State and Territory agencies naturally prioritise their compliance and enforcement activities by reference to the level of consumer detriment associated with the regulated activity in their respective jurisdictions.

The development and ongoing implementation of a nationally consistent or uniform State and Territory regulation by all jurisdictions could be expected to be a time-consuming process. Any significant delay in implementation may give rise to perceptions that the response of government had been insufficient and too slow.

### **10.3 Regulation by the Commonwealth**

There would also appear to be advantages associated with regulation by the Commonwealth:

- the relevant Commonwealth agency [ASIC] is responsible for the regulation of advice about investment in all major asset classes apart from property. The functional equivalence of investment advice in relation to property, and investment advice in relation to other asset classes, argues for a single and consistent regulatory regime with ASIC as regulator; and
- many property investment advice and wealth creation businesses operate nationally, and investment properties are bought and sold interstate on a regular basis. Thus, as we have noted in the previous sub-section, there is a need for a national regulatory response. Arguably, this may be more readily achieved through Commonwealth legislation than by a process requiring coordinated and consistent action by all State and Territory governments.

On the other hand, extensive regulation of real estate-related activities by the Commonwealth would represent a new departure, and would not be without its difficulties either. For one thing, the financial services laws have been developed to deal with financial products. These products are significantly different in character from real estate, and it is not clear that the financial services' regime could simply be extended to cover investment advice about real estate.

#### **Question 17**

If a new regulatory scheme were to be introduced, should it be a Commonwealth or a State and Territory responsibility?

## **11. Additional information**

**Question 18**

Is there any other information you wish to provide to us in connection with this review? Are there other issues you wish to raise? Do you have any further comments?

**The Australian Competition and Consumer Commission (ACCC)**

In September 2003 the Chairman of the ACCC, Mr Graeme Samuel, announced that the Commission was targeting a range of apparent misleading and deceptive conduct in the real property industry in Australia, including misrepresentation in the promotion of property seminars to inexperienced investors, and misleading aspects of property marketing and sales by various parties including real estate agents, developers, financiers and auctioneers.

The ACCC has taken legal proceedings against a number of parties under the *Trade Practices Act 1974 (Clth) (TPA)* in relation to the above conduct, and investigations are continuing in relation to other parties.

*Proceedings against Henry Kaye and National Investment Institute Pty Ltd*

The ACCC instituted proceedings against Henry Kaye and National Investment Institute Pty Ltd (NII) in the Federal Court, Melbourne on 30 September 2003. The proceedings alleged misleading and deceptive conduct under section 52 of the *TPA* with respect to the promotion of a “millionaires” property investment strategy in radio, newspaper and internet advertisements.

The ACCC alleged that Mr Kaye and NII made a number of claims including that Mr Kaye would turn 1000 ordinary people into property millionaires (meaning having net wealth in property investments exceeding \$1 million) within 12 months, and could teach anyone to acquire a million dollar plus portfolio without having to use their own money, incur any debt or provide any security, and with a guarantee that if the market were to go down they would not lose their money. As part of its case, the ACCC relied on the operation of section 51A of the *TPA* which deems as misleading any representations by a party about future matters for which the party does not have reasonable grounds.

During an initial hearing, the respondents agreed to stop such advertising of the seminars, pending the final outcome of the matter before the Federal Court. NII went into liquidation on 18 February 2004, and the ACCC continued to pursue its action against Mr Kaye. The ACCC sought declarations that in each case Mr Kaye breached the *TPA*, an injunction restraining the respondent from engaging in similar conduct and corrective advertisements on radio, in print and on Mr Kaye’s web-site. The case was heard by Justice Kenny on 9-16 March 2004, and Mr Kaye did not give evidence in his defence. Justice Kenny has reserved her judgment.

*Proceedings against USA based property seminar providers*

The ACCC has taken legal action against several USA-based property seminar providers operating in Australia in 2004.

*- National Training Conference (USA), Danko and Smith*

On 28 June 2004 the ACCC instituted proceedings<sup>66</sup> in the Federal Court Sydney against the Utah based company National Training Conference (NTC) and USA presenters William

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<sup>66</sup> *ACCC v National Training Conference and Others* (unreported 29 June 2004 Federal Court of Australia, Madgwick J.)

Danko and James Smith alleging that invitations sent to Australian consumers to attend *Financial Superstars* seminars scheduled in Brisbane, Melbourne and Sydney on 1-3 July 2004 were misleading and deceptive, for reasons including that:

- the presenters were described as “Australia’s Greatest Financial Super Stars”, when they were not Australian and had no direct experience in the Australian property market;
- dollar figures quoted in the invitations were US dollars;
- statements made in the invitations about investing in real estate related to US conditions and had no necessary application to Australian circumstances;
- the promotion of a “unique Government approved” investment did not relate to any approval by the Australian Government; and
- the strategies to be referred to during the seminars which were implied would make participants wealthy, were not guaranteed to be successful.

On 29 June the Court made consent orders requiring NTC to display signs at the seminar venues and make statements to attendees correcting the above misrepresentations. Mr Danko and Mr Smith did not proceed with their presentations.

- *Robert G Allen, Vision Pursuit and Break Free Events*

The ACCC similarly obtained consent orders from the Federal Court<sup>67</sup> against USA based Robert Allen and his promoters Vision Pursuit Pty Ltd and Giann & Giann Pty Ltd (trading as Break Free Events) concerning the *Robert Allen Millionaire Matrix* 4 day seminar in Sydney commencing 21 July 2004. The ACCC alleged that marketing material sent to consumers inviting them to attend the seminar contained misleading and deceptive statements about certain wealth creation strategies to be taught at the seminar. The ACCC alleged the promoted strategies involving private mortgage notes, brokering mobile home notes, and leveraging ‘tax certificates’ and/or ‘tax deeds’ had no application in Australia. The Court by consent ordered the promoters to place corrective signage at the venues and make corrective statements advising to attendees of the misrepresentations, and ordered Mr Allen not to make or publish such representations at the seminars or elsewhere.

*Proceedings against Oceana Commercial Pty Ltd & Others*

On 18 December 2003 Justice Keifel in the Federal Court Brisbane found that a number of companies and individuals in the ACCC’s action against *Oceana Commercial Pty Ltd* and other parties had contravened the *TPA*.<sup>68</sup>

The proceedings, which were instituted in November 2001, related to a property marketing scheme in which consumers were allegedly misled into paying prices for property on the Gold Coast at significantly higher than prevailing market prices. The ACCC alleged that the scheme involved consumers being contacted via telemarketing, followed up by seminars and in-house consultations during which the benefits of investing in property at the Gold Coast using negative gearing principles were reinforced. It was alleged that prospective purchasers were encouraged to visit the Gold Coast and that those who accepted were allocated a “runner” whose task was to show them selected properties and introduce them to a financial

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<sup>67</sup> *ACCC v Vision Pursuit Pty Ltd and Others* (unreported 20 & 21 July 2004 Federal Court of Australia, Gyles J.)

<sup>68</sup> *ACCC v Oceana Commercial Pty Ltd and Others* [2003] FCA 1516

advisor. The ACCC alleged that certain particular parties were involved, variously, misleading deceptive or unconscionable in breach of the *TPA*.

There were thirteen (13) respondents in all (details available if requested). On 18 December 2003, the Federal Court of Australia found that of the thirteen respondents, the first and second respondents had breached section 52 of the *TPA* by misleading purchasers as to the rate by which residential units at the Gold Coast would increase in value over the following ten years. The fifth, seventh and eighth respondents were knowingly concerned in such contraventions and the fifth respondent conspired with the first, second and sixth respondents to effect the contraventions. The sixth respondent was also knowingly concerned in such contraventions and conspired with the first, second and fifth respondents to effect the contraventions in the period from November 1997 to 9 September 1998.

In relation to a particular purchaser, the first and second respondents were found to have breached section 52 of the *TPA* again in relation to the rate of capital growth of a certain unit and by representing Investlend Pty Ltd as a qualified financial advisor who would act in the purchaser's interests. The fifth, seventh and eighth respondents were knowingly concerned in those contraventions and in the case of the fifth respondent, conspired with the first and second respondents to effect those contraventions. According to Justice Kiefel the ACCC did not establish that the prices paid were above the fair market value or that the lawyer involved in the conveyancing of the property had contravened the Act.

The Commonwealth Bank of Australia provided the loan to the consumers in this case, they were not part of the marketeering operation. The case against the bank was an allegation of unconscionable conduct and misleading and deceptive conduct for failing to inform the consumers that the bank valuation suggested that the customers had paid too much for the property. Her Honour Judge Kiefel held for various reasons that the bank was not guilty.

The ACCC appealed the primary judges decision and the appeal was heard by the Full Federal Court on 20 & 21 May 2004. Mr Dudley Quinlivan, the sixth respondent, also appealed the judgment against him that he was knowingly concerned in the conduct and that appeal was heard by the Full Court on 27 & 28 May 2004. On 5 July 2004 the Full Court released its decision on both appeals, dismissing the ACCC's appeal and allowing the appeal by Quinlivan.

The ACCC is considering its options, including whether there are grounds to lodge an appeal with the High Court.

#### *Enforceable undertakings requiring refunds by Hill End Property Group directors*

On 11 May 2004 the ACCC accepted court enforceable undertakings from former and current directors of the property developer Hill End Recreational Park Pty Ltd (trading as Hill End Property Group) requiring them to place corrective notices and refund consumers following an investigation into alleged misleading or deceptive conduct in the sale of land at Hill End, in central NSW.

Between December 2003 and February 2004 the company, in advertisements in Sydney newspapers, in brochures, and via its website, promoted the sale of various sized blocks of land ranging from 80 square metres for \$1,290 to one acre for \$50,000. The company implied that freehold title to blocks would be provided, that the land was suitable for the building of dwellings, and a development application for building permits was to be

submitted to the local council. Over \$80,000 in deposits and other payments were made by more than 30 consumers.

Investigations revealed that individual buyers would not have received freehold title to any block but rather 1/100,000 share of the 12.5 hectares under subdivision. Further, the company did not own the land proposed for the subdivision, rather the company held an option to buy it, however that option was not exercised - consequently purchasers could not obtain title to a share of the land. Also, local government restrictions would have prevented approval of subdivision of the land and its use for the building of multiple dwellings.

The company's directors, Mr Brendon Davenport and Mr Michael Braithwaite, acknowledged that consumers were misled by the actions of the company and its representatives, and they gave personal undertakings to the ACCC to ensure all purchasers would receive full refunds. The company's representative, Mr Chris Sharp, had his authority to sell land on the company's behalf revoked, and no longer acted for the company. An Administrator subsequently appointed to the company is administering the distribution of refunds to consumers.

#### *Other actions and activities*

In December 2003 the ACCC instituted legal proceedings in the Federal Court concerning alleged misleading and deceptive conduct by a real estate agency for allegedly under-quoting the expected price range of a property in Victoria for sale by auction. The case is likely to be heard in late 2004.

The ACCC has liaised extensively with the Real Estate Institute of Australia (REIA), as well as with its various State and Territory chapters, regarding real estate and property marketing issues. The ACCC provided the REIA with a short summary of broader concerns in relation to conduct in the real estate sector. The REIA has used this summary to develop a code of conduct for real estate agents and auctioneers addressing the issues of concern for distribution to its members.

The ACCC is also revising its trade practices guide for the real property sector entitled "Fair and Square"<sup>69</sup> with assistance from the REIA.

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<sup>69</sup> The current version of 'Fair and Square' can be found at:  
<http://www.accc.gov.au/content/index.phtml/itemId/321931/fromItemId/341173>

## **The Australian Securities and Investments Commission (ASIC)**

### *Proceedings against Henry Kaye and National Investment Institute*

ASIC has taken Henry Kaye and companies associated with him to court on four separate occasions since March 2003.

In March 2003, ASIC commenced Federal Court proceedings against Mr Henry Kaye, NII and others. In those proceedings, ASIC alleged that NII, Mr Kaye and others had disseminated false information and misleading and deceptive information in connection with mezzanine mortgage lending facilities and the related NII training courses. ASIC's concerns related to statements that investment opportunities and training programs allegedly promoted by NII were approved by ASIC, which they were not. ASIC alleged that the statements were misleading and deceptive, in breach of the *ASIC Act*, the *Corporations Act 2001 [CA]* or the *TPA*.

ASIC also alleged that NII and Mr Kaye had been carrying on a financial services business without a license, in breach of section 911A of the CA, on the basis that they had provided financial product advice in relation to mezzanine mortgage products.

ASIC obtained court orders and enforceable undertakings from Mr Kaye and companies associated with him in July 2003. The undertakings included an arrangement for the payment of compensation to consumers who paid for NII training courses in reliance on the statement by NII alleging that the training courses had been approved by ASIC. ASIC went back to court in relation to alleged breaches of those undertakings in October 2003. In December 2003, ASIC sought the appointment of a receiver or trustee to Mr Kaye and related companies.

A number of the Henry Kaye companies entered into external administration in late November 2003 and between December 2003 and March 2004, ASIC was involved in numerous court applications and formal interventions to ensure creditors' interests were protected. Ten companies formerly controlled by or associated with Mr Kaye are now in liquidation and, as a result of ASIC's intervention, a further company controlled by Mr Kaye, Property Corporate Services Pty Limited, was wound up on 12 March 2004.

ASIC's investigations are continuing.

### *Other actions*

ASIC regularly takes action against unregistered or unlicensed managed investment schemes promoting property investment, as well as individuals associated with such schemes. It also undertakes surveillance and enforcement action to ensure that property trusts are properly managed and that investors are properly informed about their affairs. In addition, ASIC has undertaken action on several occasions against property development companies and individuals involved in illegal fund raising activities.

Examples follow of some recent matters (July 2004) in which ASIC took action in respect of wealth creation seminars. These seminars primarily provided real estate advice, but ASIC took action where it was concerned that the seminar presenters had breached consumer protection provisions, or would provide financial advice without being licensed to do so.

ASIC sought orders against Online Investors Advantage Incorporated (OIA) regarding a series of *Financial Superstars* seminars in Brisbane, Sydney and Melbourne. ASIC was concerned that certain representations would be made at the seminars that were outside the terms of OIA's Australian financial services licence, and that some misleading and deceptive representations had been made on the registration form for the workshops. The court declined to make interim orders stopping the workshops, however OIA provided a number of undertakings to ensure that consumers attending the workshops were fully informed. ASIC obtained undertakings from the promoter of the *One Minute Millionaire* seminar presented by American Robert Allen in Sydney on 21 July 2004, because neither the promoter nor Mr Allen hold an Australian financial services licence. The promoter and Mr Allen made changes to the content of the seminar to comply with the undertakings.

Undertakings were obtained from Pow Wow Events, the promoter of American John Burley's *Winning the Money Game* and *Automatic Wealth* seminars in Sydney in July and August, to ensure that unlicensed financial advice was not given.

Apart from its surveillance and enforcement activities, ASIC has issued a number of Consumer Alerts in relation to investment seminars, mezzanine investing and investing in real estate. ASIC's consumer website FIDO ([www.fido.asic.gov.au](http://www.fido.asic.gov.au)) contains detailed information on these and related themes (follow links from "investment seminars").

### **Consumer Affairs Victoria (CAV)<sup>70</sup>**

Consumer Affairs Victoria (CAV) is committed to enforcing laws capable of addressing issues relating to property investment advice. CAV also sees property investment advice as part of a broader set of issues including credit and finance. Credit and finance issues were designated as a priority area for CAV late in 2002.

CAV has taken action on several fronts to both protect and inform consumers of the activities of Henry Kaye. In 2001, following consumer complaints, CAV commenced an investigation into the activities of Henry Kaye and National Investment Institute (NII). In January 2002, CAV successfully sought orders in the Melbourne Magistrates Court requiring substantiation of testimonials relating to the success of the Henry Kaye property investment strategy published by or on behalf of Henry Kaye and Investmentsource Pty Ltd. CAV also secured \$140,000 in refunds for some consumers through direct negotiations with NII.

CAV has received a number of complaints from consumers who have enrolled to undertake property investment and wealth creation seminars and/or courses run by NII and Australian Finance Direct Ltd (AFD). In the conduct of its business NII has referred customers who are seeking to enrol in its courses to AFD for the provision of credit to pay for the cost of the course. These referrals are made pursuant to a formal introduction agreement between AFD and NII.

CAV made an application against AFD alleging that their contracts which financed NII courses breached key disclosure requirements under the Consumer Credit Code. The application sought a declaration that the alleged AFD conduct constituted a breach, and the imposition of a civil penalty against AFD.

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<sup>70</sup> Updated 31 August 2004.

On 15 July the Victorian Civil and Administrative Tribunal (VCAT) handed down a decision in favour of CAV. VCAT is yet to deal with the question of what, if any, penalty should apply.

The breaches relate to the non-disclosure of a "holdback" which was retained by AFD by withholding a percentage of the loan from the amount paid out to NII. VCAT found that this holdback amounted to interest, and therefore should have been disclosed as such. VCAT also found that the credit contracts incorrectly stated the whole of the amount of the loan was to be paid to NII, when this was not the case.

A related successful prosecution has been that against a firm undertaking property sales (for domestic purposes), but involved in the same sort of mixed high pressure sale tactics and lending practices often used by property investment advisers.

The Director of CAV brought action against Perna Pty Ltd, Astvilla Pty Ltd and Livio Cellante alleging that each of them engaged in unconscionable conduct and deceptive and misleading conduct when selling a house on vendor terms to a consumer. Mr Cellante and employees of his companies persuaded the consumer to purchase a house in Warracknabeal, initially under a vendor term contract, for \$55,000 that they were only in the process of purchasing for \$25,600.

The Magistrate's Court decided to award a \$31,584 refund after the consumer was misled and treated unconscionably by property companies when buying her first home. Not only was the Warracknabeal house overvalued, Mr Cellante and his companies did everything they could to conceal the true value of the house from Ms Brown. The court found that sales pressure prevented Ms Brown from:

- looking around the township;
- seeking independent or expert advice;
- examining advertised property values in estate agents' windows; and
- gathering information to ascertain if she was paying too much.

Ms Brown was also prevented from making a considered decision by their insistence that she had to pay a deposit immediately to secure the house it was said was in demand. In fact, the house had been on the market for at least seven years.

The defendants were found by the Magistrate to have contravened section 7 of the *Fair Trading Act 1999* (FTA) when they engaged in unconscionable conduct in their dealings with a person who could not match them in terms of knowledge or experience. The magistrate also found that they had breached section 9 of the FTA when they engaged in misleading and deceptive conduct.

CAV has a commitment to informing consumers regarding property investment advice and associated activity. Over the past two years, CAV has issued a number of media releases including a Ministerial column to all Victorian country papers warning consumers about property investment seminars. CAV continues to keep consumers aware of action being taken by CAV, particularly against AFD. CAV has released fact sheets on such issues as 'vendor terms contracts' and 'investment seminar and get rich quick schemes'.

## **The Queensland Office of Fair Trading (QOFT)**

The Queensland Office of Fair Trading (QOFT) has issued media releases warning consumers to be cautious and to seek independent advice about information provided by property investment advisers, and has a property investment advice fact sheet available on their web-site since July 2001. QOFT has commenced proceedings in the Commercial and Consumer Tribunal against a number of respondents for alleged breaches of the marketeering provisions of the *Property Agents and Motor Dealers Act 2000*. The alleged breaches relate to misleading and deceptive conduct and misrepresentations arising out of property transactions that included purchasers attending property investment seminars. QOFT also has a number of current investigations into property investment related matters.

In Queensland, several actions have been taken by consumers against National Asset Planning Corporation Pty Ltd, Mr Christopher Bilborough and others in the then Queensland Property Agents and Motor Dealers Tribunal for contraventions under the relevant Queensland real estate legislation for property marketeering. A number found that there were false and misleading representations relied upon by the purchasers in executing the contract to purchase the property, therefore the relevant respondents were in breach of section 72 of the repealed *Auctioneers and Agents Act 1971*.

QOFT has also produced a “Good Business Guide for Real Estate Agency Practice” which was produced with assistance from the Real Estate Institute of Queensland in 2001 and is systemically sent to all licensees.<sup>71</sup>

## **The New South Wales Office of Fair Trading (NSW OFT)**

The New South Wales Office of Fair Trading (NSW OFT) has had a low level of complaints. The NSW OFT served a substantiation notice pursuant to section 23A of the *Fair Trading Act 1987* (NSW) on Morgan Pacific Pty Ltd, which is operated by Danny and Paul Hanna to substantiate representations made in relation to their wealth creation seminars. The NSW OFT has also taken action against the Radisson Maine Financial Group (Australia) Pty Ltd and Nicolai Popov and Robert Bassili in relation to misrepresentations in breach of the *Fair Trading Act 1987* (NSW). The defendants consented to Orders being granted that required corrective advertising, required a notice to be published on their web-site, required them to offer refunds to all existing customers and to give service disclosure notice to all new or prospective customers. This action was accompanied by warnings to the public by the Minister about the potential problems that can occur with seminars.

## **Western Australia’s Department of Consumer and Employment Protection (DOCEP)**

In response to increasing concerns regarding property investment promoters Western Australia's Department of Consumer and Employment Protection (DOCEP) ran a full page advertisement in Western Australia's daily newspaper in late 2002 warning consumers of the need for independent research prior to committing to significant investments. Information provided included commentaries from academics and financial advisors about cyclical profitability of property over shares, the importance of investment diversity and full assessment of risks. DOCEP also ran a property investment seminar of its own in October 2003, with the objective of providing reliable and factual information to property investors. Six hundred people attended the seminar that included topics such as how to choose an

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<sup>71</sup> The OFT Qld Good Business Guide for Real Estate Agency Practice can be located at: <http://www.fairtrading.qld.gov.au/oft/oftweb.nsf/web+pages/609246C5B219A3734A256B440031204F?OpenDocument&L1=Publications> (or visit [www.fairtrading.qld.gov.au](http://www.fairtrading.qld.gov.au) click on publications, business)

advisor, how to compare mortgage terms, researching property prices and trends, and taxation arrangements for rental properties.

DOCEP has continued to issue media releases and warnings to the public about the techniques used by property investment promoters. Additionally staff have been enrolled on most courses to monitor the representations made.

In July 2004, DOCEP sent a letter of demand to the Mr Jack Weaver, Director of Oneworld Seminars Pty Ltd requiring a number of corrective actions following his advertising of a property investment seminar that was believed to be misleading. Mr Weaver agreed to remedy the concerns by:

- publishing corrective advertising in the relevant publications;
- contacting participants who had registered informing them of the correction;
- providing a list of all participants registered to date to DOCEP; and
- offering refunds to those participants who request one as a result of the correction.

Mr Weaver was also required to substantiate the claims that significant wealth had been created by several individuals after using strategies learnt at seminars. Neither the corrective actions nor responses to the request for substantiation have been satisfactory. DOCEP lawyers attended the scheduled seminar on 31 July 2004 to inform attendees of the concerns about advertising and the opportunity for refunds. DOCEP is currently obtaining further evidence and it is anticipated that prosecution action will be commenced in August or September 2004.

### **Other State and Territory Fair Trading Agencies**

The Australian Capital Territory has only had two complaints and both were resolved to the satisfaction of the consumers, with full redress being obtained for one. South Australia has had few complaints in this area. The Northern Territory has not received any complaints in relation to property investment advice.

## Introduction

This Appendix summarises the regulation of financial product investment advice under Chapter 7, *Corporations Act*.

The following preliminary points should be noted:

- this summary is intended for the general, non-expert reader seeking an understanding of the financial product advice regime for the purposes of the current Discussion Paper. Various exemptions from, and qualifications to, the requirements set out in the legislation have not been noted;
- the summary only deals with those aspects of the regulation of financial services relevant to financial *advice* (as distinct from other financial services, like dealing in a financial product);
- the summary does not cover the *product* disclosure requirements of the financial services laws (as distinct from *adviser* disclosure requirements); and
- the requirements outlined are those applying to *retail* clients of financial advisers<sup>72</sup>—the financial services laws also apply to wholesale clients, albeit to a more limited extent; however, the differences are not discussed here.

## What are 'financial products'?

'Financial products' are defined broadly under the financial services laws and include: shares and debentures; derivatives; interests in managed investment schemes; life insurance contracts; general insurance contracts; interests in superannuation funds; Retirement Savings Accounts; debentures, stock, or bonds issued by a government; foreign exchange contracts; and deposit-taking facilities.

## What advisory activities are regulated by the financial services laws?

Under the financial services laws, a person provides financial product advice when they:

- recommend or state an opinion (or report a recommendation or opinion) that is intended to influence someone in making a decision about a financial product; or
- when their recommendation, opinion or report could reasonably be regarded as being intended to have such an influence.<sup>73</sup>

The financial services legislation identifies two types of financial product advice, *personal advice* and *general advice*.<sup>74</sup> *Personal advice* is advice that is given or directed to someone in circumstances where the adviser has considered the person's financial objectives, their financial situation or their financial needs, or where a reasonable person might expect the adviser to have considered one or more of those matters. Financial product advice is *general advice* if it is not *personal advice*.

Note that mere information about a financial product—information that could not reasonably be regarded as being intended to influence decision-making—is not 'captured' by this

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<sup>72</sup> See section 761G, *CA*, particularly s761G(7)

<sup>73</sup> See section 766B, *CA*

<sup>74</sup> *ibid*

regime for regulating advice-giving. On the other hand, subject to limited exceptions, the regime applies to anyone carrying on a financial services business who is involved in giving advice, within this broad conception. In other words, it is the activity of giving advice about a financial product that is regulated, generally irrespective of who is engaged in that activity.

### **What regulatory requirements are imposed on financial product advisers?**

Financial product advisers are required either to be an Australian Financial Services licence-holder or their Authorised Representatives [ARs]. Licensees must comply with the conditions on their licenses, and must operate within the limits of the licence. For instance, if a licensee is authorised to give advice about certain classes of financial product only, neither it nor its ARs may give advice about other classes of products.

As the regulator, ASIC has power to vary, suspend or cancel a licence-holder's licence where the licensed business ceases to operate or becomes insolvent under administration, or the licensee is convicted of serious fraud, breaches its obligations under the financial services laws, or becomes mentally incapable etcetera.

A basic feature of the regime is that licence-holders are generally responsible for ensuring that their ARs comply with their legal obligations and that they are adequately trained and competent to provide the services for which they are authorised. Licence-holders are generally liable for negligent and other misconduct of their ARs. Conduct and disclosure obligations are also imposed directly on ARs. Key obligations imposed under the regime are summarised in the following paragraphs.

#### *Disclosure obligations imposed on advisers*

Before providing its services, a financial product adviser (whether licence-holder or AR) must generally give its clients mandatory written information about its services in the form of a Financial Services Guide. This information must cover (among other things):

- the adviser's name and contact details;
- in the case of ARs, the name of the licensee on whose behalf it acts;
- the products and services the adviser is authorised to provide;
- information about remuneration (including commissions) and other benefits it receives;
- information about any associations and relationships that might reasonably be expected to be capable of influencing it; and
- information about its dispute resolution system (discussed below).

This information must be provided to a level that a person would reasonably require to make a decision to acquire the adviser's services. The information must generally be provided whether general or personal advice is given, including where general advice is given in a public forum. However, the requirements are somewhat less demanding in the public forum context.

#### *Additional specific obligations imposed where personal advice is given*

Where the adviser considers, or might reasonably be expected to have considered, the client's individual financial objectives, financial situation or financial needs in giving their

advice, the adviser is regarded as providing ‘personal advice’. As such, it is subject to a number of other obligations, apart from the disclosure requirements mentioned in the previous paragraph. In particular:

- the adviser’s advice must generally either be in the form of a written Statement of Advice [SOA], or their advice must be summarised in an SOA;
- the SOA must set out the basis for the advice, as well as the advice itself; and
- the adviser must have a reasonable basis for its advice. If you are giving personal financial advice, you must ‘know your client’ and ‘know your product’, and undertake whatever inquiries and research are necessary to make sure that any product you recommend is appropriate to the client’s needs and objectives.

*Additional specific obligations imposed where general advice only is given*

On the other hand, where general advice only is given the client must be warned that the advice does not take account of their objectives, financial situation or needs; and that the client needs therefore to consider the appropriateness of the advice to their situation.

*General obligation to act efficiently, honestly and fairly*

This positive obligation, which goes well beyond the prohibitions of misconduct under the general consumer protection laws, applies to all licensees. A separate prohibition of dishonest conduct in the course of carrying on a financial services business also applies to ARs. (Dishonesty here is defined ‘according to the standards of ordinary people’.) As we have noted, the general consumer protection regime also applies in relation to financial product advice.

*Obligation of licensee to ensure staff and ARs are adequately trained and competent to provide services*

As regulator, ASIC has developed a detailed policy that set minimum standards designed to ensure that licensees and their representatives are adequately trained and competent to provide the services (for example general advice, personal advice) covered by their licenses: see *Policy Statement 146 Licensing: Training of Financial Product Advisers* and *Licensing: The scope of the licensing regime: Financial product advice and dealing—An ASIC Guide*.

*Obligation of licensee to maintain certain organisational capacities*

These are set out in ASIC *Policy Statement 164, Licensing: Organisational capacities* and cover such areas as compliance and risk managements systems.

*Obligation of licensee to have a dispute resolution system*

Licence-holders must have an internal dispute resolution procedure that meets specified standards (currently those of *AS-4269 Australian Standard on Complaints Handling*). In addition, license-holders are required to belong to one or more independent external dispute

resolution schemes, covering the range of the licensee's retail activities. The schemes in question must be ones that have been approved by ASIC.

#### *Obligation of licensee to satisfy financial requirements*

These are set out in ASIC *Policy Statement 166 Licensing: Financial requirements*. The policy applies to all entities that are not regulated by the Australian Prudential Regulation Authority. Its purpose is to ensure that:

- licensees have sufficient financial resources to conduct their business in compliance with the *Corporations Act* (including carrying out supervisory arrangements);
- there is a buffer that decreases the risk of a disorderly or non-compliant wind-up if the business fails; and
- there are incentives for the owners of the business to comply with their obligations through risk of financial loss.

#### *Obligation of licensee to have professional indemnity insurance (or equivalent arrangements)*

This aspect of the financial services regulatory framework is still to be finalised. However, the Commonwealth government has decided that AFS licence-holders will generally be required to hold professional indemnity insurance, or have alternative equivalent arrangements. The purpose of this requirement is to ensure that licence-holders are able to satisfy established claims by their clients for breaches of their legal obligations by the licensee or its ARs.

#### *Product-hawking limitations*

Offering financial products for issue or sale in the course of, or because of, an unsolicited meeting with another person is generally prohibited. Unsolicited telemarketing of most financial products is permitted subject, however, to a range of controls and limitations.

#### *Cooling-off right for some products*

A client has a 14 day period during which they can return a financial product and have the money they paid to acquire the product repaid. The right only applies to certain classes of financial product; and the client must not have exercised any right or power they had under the terms of the applicable product.

**CONSUMER COMPLAINTS RECEIVED IN 2003**

**APPENDIX C**

| <b>State/Territory or Commonwealth organisation</b> | <b>Time-frame</b> | <b>Number of complaints</b> | <b>Types of complaints</b>  |
|---|-------------------|-----------------------------|---|
| QLD   | 2003              | 13                          | 5 in relation to marketeering conduct in 2003 and 8 in relation to seminars.  |
| NSW   | 2003              | 14                          | Property investment seminars.   |
| VIC   | 2003              | 70                          | 70 complaints, of which 64 complaints were against the National Investment Institute or other Henry Kaye related companies.         |
| SA  | 2003              | 4                           | All 4 complaints related to National Investment Institute.  |
| WA  | 2003              | 1                           | 1 complaint about property investment seminars.   |
| ACT   | 2003              | 2                           | Property investment advice.   |
| NT  | 2003              | 0                           | No complaints have been received.   |
| TAS   | -                 | -                           | Not provided. Not part of Working Party.  |
| ACCC  | 1/9/03 – 20/02/04 | 308                         | -140 property seminar complaints;<br>-31 developers and associated parties;<br>-48 property marketing; and<br>-89 other complaints. |
| ASIC  | 8/12/02 – 8/12/03 | 350                         | Property investment advice, 20% of which related to Henry Kaye and the National Investment Institute.                               |
|   | <b>TOTAL</b>      | <b>762</b>                  |   |