



7 September 2007

Kerryn Riseley
Executive Officer,
Victorian Parliament Law Reform Committee
Parliament House
Spring Street
MELBOURNE VIC 3002

Dear Ms Risley

Law Reform Committee Inquiry into Property Investment

Consumer Action Law Centre (**Consumer Action**) is pleased to have the opportunity to make a submission to the Victorian Parliament Law Reform Committee's (the **Committee**) Inquiry into Property Investment (the **Inquiry**).

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign focused, casework and policy organisation. It was formed by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service in 2006, and builds on the significant strengths of these two centres.

Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and throughout the community directly.

Overview of submission

Consumer Action believes there is an urgent need to improve the regulation of the provision of property investment advice. Although property investment advisers are currently regulated by the consumer protections provisions of the *Trade Practices Act 1974* (Cth) (**TPA**) and *Fair Trading Act 1999* (Vic) (**FTA**), these laws do not compel property advisers to disclose either the potential financial risks to investors or any conflicts of interest, such as receiving commissions. Providers of property investment advice are not licensed, and we

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believe that the law should be changed to impose mandatory conduct requirements on such providers.

In our view, the licensing of providers of property investment advice should be federally regulated through a regime similar to the Australian Financial Services (**AFS**) licence scheme in the *Corporations Act 2001* (Cth) (the **Corporations Act**). We note that application of the AFS licensing regime to providers of investment property advice was recommended by the Commonwealth Parliament Joint Committee on Corporations and Financial Services in 2005.¹ Consumer Action is generally supportive of the findings of this Committee.

We note that an alternative response could involve the States and Territories enacting uniform regulation of property investment advisers. This could be achieved through the work of the Ministerial Council on Consumer Affairs (**MCCA**). We note, additionally, that regulation of property investment advisers is included in MCCA's strategic agenda, dated September 2005.² MCCA states that a Regulatory Impact Statement was being drafted by the Commonwealth. Despite this, there has been no further action taken by MCCA in relation to property investment advice. It is our view that the Committee should ensure that the regulation of property investment advice is high on the priority of MCCA, and for any delays to be publicly explained.

Common problems with property investment advice

We note media reports which imply that the Inquiry is responding to recent collapses by multimillion-dollar property-backed debenture companies such as Westpoint, Fincorp and Australian Capital Reserve.³ We note that debentures are currently regulated by the Corporations Act, and that any regulatory changes aimed to better protect retail investors in debentures should be undertaken through amendments to the Corporations Act and/or the powers of the Australian Securities and Investment Commission (**ASIC**). We would not support additional state regulation of such schemes, which would only create duplication and increase compliance costs.

There are, however, a number of property investment advisers and schemes which evade the regulatory protections in the Corporations Act. This results in significant variability in the quality of advice services. In particular, individual advisers, through advertising and marketing campaigns, as well as through education seminars, present particular problems for consumers. Consumer Action and its predecessors have had particular experience with consumers who owed money as a result of attending National Investment Institute (**NII**) schemes (run by the infamous Henry Kaye). NII and similar schemes⁴ generally charge a high upfront fee for participation and evade the AFS regime by purportedly providing 'education' rather than financial advice. 'Education' is commonly also advice about property investment. Consumers regularly report high-pressure sales tactics, difficulties in getting a refund, as well as speakers' unwillingness to assist or respond to requests for assistance.

¹ Parliament of Australia, Joint Committee on Corporations and Financial Services, Report of the Inquiry into Regulation of Property Investment Advice, 'Property Investment Advice – Safe as Houses?', June 2005.

² See http://www.consumer.gov.au/html/download/Strategic_Agenda_2_Sept_2005.pdf.

³ Leonie Wood, 'Inquiry to rein in rogue property advisers', *The Age*, 29 June 2007.

⁴ For example, the Today Not Tomorrow Institute, marketed by former NII employee, George Mihos.

We have also become aware of the promotion of property investment strategies or schemes such as “wraps” (vendor terms) or lease options, through providing advice to consumers who have purchased properties from the investors. These arrangements often cause problems for the purchasers, including:

- risks involved if the ‘investor’ fails to maintain payments on his or her mortgage;
- high costs;
- low quality housing requiring significant spending on maintenance; and
- complex legal arrangements.⁵

We note that the other party (the investor) has often followed this strategy on the advice of someone who has arranged the contracts, or from a book, kit, educational seminar or website. We believe that in some cases it is likely that investors have not been provided with balanced advice and that investors – as well as purchasers – could be at risk using some of these strategies.

Finally, property investment advisers are commonly tied to a range of other entities, including lenders, brokers, estate agents and conveyancers. For example, consumers who attend an investment advice seminar are often referred to other parties directly, without the chance to shop around. There are often high fees paid to all those involved. Such complex arrangements add additional consumer detriment, particularly where there are fees and charges passing between the different parties. Inappropriate management of conflicts of interest can lead to poor advice from advisors.

Current regulatory situation

The provision of property investment advice is currently subject to the general consumer protection provisions (such as protection against misleading and deceptive conduct and unconscionable conduct) contained in the TPA and FTA. The consumer protection provisions in the *Australian Securities and Investments Commission Act 2001* (Cth) (the **ASIC Act**) apply only to financial services, and contain consumer protection provisions that mirror those in the TPA. As property investment is not included in the definition of financial services, the consumer protection provisions in the ASIC Act would not apply to property investment advice.

Queensland has enacted provisions specifically relating to property marketeering,⁶ however as these provisions do not create licensing requirements and do not clearly impose conduct standards, they do not represent a satisfactory solution to the problem. In circumstances where property is purchased with debt, the *Uniform Consumer Credit Code* (the **Code**) may apply (such as was commonly the case with the NII seminars). The need for there to be a provision of credit for the Code to apply means that it does not cover the provision of property investment advice and will be inapplicable to many transactions involving the giving of such advice.

⁵ For further detail, see Consumer Action Law Centre, *Vendor terms – rhetoric & reality?*, February 2007, available at: <http://www.consumeraction.org.au/downloads/Vendortermreport-final.pdf>.

⁶ *Property Agents and Motor Dealers Act 2000* (Qld).

The current regulatory approach does not provide for control and oversight of the behaviour of providers of property investment advice to the extent that mandatory licensing would. For example, ASIC, as the regulator has clear monitoring, compliance and enforcement powers with respect to AFS licence holders. While state and territory fair trading agencies can take action if a property investment adviser breaches the law, any action will be corrective only. The lack of licensing means that there is not an environment of high conduct standards nor pro-active monitoring and compliance by a regulator. Consequently, the legal framework as it currently stands means that regulators only prosecute the most egregious wrongful conduct of property investment advice providers.

A particular benefit of the AFS licence regime is the licence condition that requires licensees to be members of an ASIC-approved external dispute resolution (**EDR**) scheme. EDR schemes are of particular benefit to consumers who experience problems with service providers, as these schemes are generally free, accessible, informal and quick. Other obligations imposed on AFS licensees include fitness and probity requirements, duties to act fairly and honestly, and requirements to train personnel. Considering the nature of property investment advice, and its similarities with other financial investment advice, we believe that similar requirements should be placed on property investment advisers.

As noted above, property investment advisers commonly work in tandem with a range of other entities, including brokers and lenders, resulting in significant conflicts of interest. While there continue to be problems with respect to conflicts of interest in the provision of financial services, ASIC has undertaken some work to address the issue.⁷ If property advisers came within the scope of ASIC regulation, then this issue could at least be partly addressed.

Regulatory approach – the way forward

For the reasons outlined above, we believe that provision of property investment advice should be subject to a regulatory regime similar to financial services. We see no reason why the regulatory environment for property advice should be any different to financial advice. Arrangements for investing in property are typically complex, and involve a significant amount of risk for even the wary investor.

We would not support a self-regulatory approach to property investment advice. The market for property investment advice is characterised by a very large number of participants, low barriers to entry, and often little repeat custom and therefore low concern for reputation. As recognised by the 2005 federal parliamentary inquiry into property investment, in such an environment, self-regulation is inappropriate and would not work.⁸

We note that requiring providers of property investment advice to be licensed may increase compliance costs for such providers, and this may conceivably increase the cost of provision

⁷ Australian Securities and Investment Commission, *Policy Statement 181 Licensing: Managing conflicts of interest*.

⁸ Parliament of Australia, Joint Committee on Corporations and Financial Services, *Report of the Inquiry into Regulation of Property Investment Advice, 'Property Investment Advice – Safe as Houses?'*, June 2005, paragraph 2.86.

of this advice to consumers. We believe, however, that such cost increases would be more than outweighed by the benefits consumers would receive from the improved protection that licensing would bring.

Problems with disclosure

Consumer Action continues to be concerned about disclosure requirements in the financial services industry, which in many respects are inefficient and ineffective. Currently, the Corporations Act relies heavily on the use of disclosure – requiring financial services advisers to give consumers a mass of information about the products being recommended. Commonly, consumers are overwhelmed by such information and do not read it. Considering this, we would not support the wholesale imposition of disclosure requirements on property advisers.

There is also some evidence to suggest that when conflicts of interest are disclosed, consumers are actually more trusting of an adviser, rather than less. US behavioural economics studies have found that “people generally do not discount advice from biased advisors as much as they should, even when advisors’ conflicts of interest are disclosed [and] disclosure can increase the bias in advice because it leads advisors to feel morally licensed and strategically encouraged to exaggerate their advice even further.”⁹

While disclosure regimes are intended to help consumers make more informed decisions, they do not necessarily have this effect. Prohibiting certain types of conflicts, or making it clear that an intermediary was an agent of the seller rather than the consumer, might be a more effective way of addressing this issue.

In our view, the Committee could also more usefully consider some more effective policy responses to ensure consumers are best equipped to make the best choices. For example, we understand that many consumers who invested in entities like Australian Capital Reserve or Fincorp responded to advertisements implying that the products were secure. Better monitoring of the content of advertisements could be a more effective response than requiring comprehensive and confusing disclosure.

Conclusion

Consumer Action looks forward to the Victoria Government highlighting and pursuing the issue of the regulation of property investment advice within MCCA and with the Federal Government. In addition, the Committee could usefully consider recommendations to improve the operation of MCCA, so that items for consideration are not repeatedly delayed, exacerbating consumer detriment. In our view, the preferred outcome from the Inquiry would be recommendations for a more efficient MCCA and for there to be definite time-frames set-down for the necessary changes to federal law that are required to effectively regulate property investment advice.

⁹ See Cain, D.M., Loewenstein, G. & Moore, D.A. 2005. *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*. *Journal of Legal Studies*. 34: 1 - 25.

Should you have any questions in relation to this submission, please contact us on 03 9670 5088.

Yours sincerely

CONSUMER ACTION LAW CENTRE

A handwritten signature in black ink that reads "Gerard Brody". The signature is written in a cursive, flowing style.

Gerard Brody
Director – Policy & Campaigns