



REIA SUBMISSION ON THE FINANCIAL SERVICES AND CREDIT REFORM GREEN PAPER

PROPOSAL

1. The Real Estate Institute of Australia (REIA) asserts that the regulation of property related financial advice is primarily a responsibility for the Commonwealth rather than State and Territory governments. While the sale of property (including property law and real estate licensing) is regulated at the State and Territory level, matters relating to the provision of personal financial advice, whether in relation to property or other asset classes, should be regulated under the Financial Services Reform (FSR) Act 2001, with ASIC as the single national regulator.
2. Specifically, the REIA proposes that:
 - a. anyone providing financial investment advice which compares investment in property to other asset classes, or personal investment advice relating to matters such as borrowings, should be licensed under the FSR Act;
 - b. anyone who sells real property (as their business) must be licensed in accordance with State and Territory legislation;
 - c. those who are licensed to provide financial services advice and/or sell real property should comply, at least, with education and training standards already in place;
 - d. real estate practice is already highly regulated by the State and Territory governments, therefore any change to regulations should not unduly affect the 'high street' real estate agent in accordance with the current application and spirit of the intention of the FSR Act; and
 - e. there should be reform of existing FSR legislation with additional requirements short of a full licensing regime because it would enhance conduct and disclosure requirements and ensure that these measures apply to all those who give property investment financial advice.

BACKGROUND

3. The REIA welcomes the release of the Federal Government's Green Paper on *Financial Services and Credit Reform – Improving, Simplifying and Standardising Financial Services and Credit Regulation*. The paper represents an opportunity for the Federal Government to address a raft of outstanding matters in respect of which the community has been concerned for some time.

4. The property market is a major source of wealth creation for investors, contributing significantly to the socio-economic well being of all Australians. For example, in the financial year 2005/2006 property sales in Australia were in excess of \$240 billion; 64.1% of Australians owned their own houses and 26.5% rented on the private market. Property affects everybody in Australia.

5. The REIA is the national professional association for the real estate industry in Australia. REIA is a politically non-aligned organisation that provides researched and well-informed advice to the Federal Government, Opposition, media, and the public on a range of issues affecting the property market. The REIA has eight members, comprised of the State and Territory Real Estate Institutes, through which about 80 per cent of real estate firms and licensed agents are collectively represented.

6. During 2002 - 2008, the REIA has made several public statements regarding unregulated property investment marketers, calling upon State and Federal Governments to address consumer and industry concerns as a matter of urgency.

7. In October 2004, the REIA made a submission to the Ministerial Council on Consumer Affairs (MCCA) Working Party on Property Investment. In January 2005, the REIA made a submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the Regulation of Property Investment Advice. While it has been some three years since the Parliamentary Joint Committee report was provided, at the time of making this submission the final MCCA report has not been tabled. Given that MCCA is the most appropriate forum for the Commonwealth and State and Territory governments to resolve this issue, the MCCA report must be finalised with the highest priority.

8. In June 2007, the Victorian Parliament Law Reform Committee (VPLRC) commenced an Inquiry into Property Investment with a Final Report released during April 2008 which, among other things, recommended that:

The Victorian Government should propose to the MCCA at its 2008 meeting:

- a. that the Commonwealth Government regulate property investment advisers;*
- and*
- b. that real estate or property transactions should continue to be regulated by the States and Territories.*

9. The VPLRC also recommended that the Commonwealth Government amend the *ASIC Act 2001* and the *Corporations Act 2001* so that advice about direct property investment is included in the financial services regime. A specific exemption was proposed for licensed real estate agents provided that they confine their advice to:

- a. past or present property returns;
- b. future returns, provided that the advice is general and that it relates to a particular property or properties.

10. This REIA supports these recommendations.

ISSUES

The Effectiveness of Current Regulation in Protecting Consumers

11. For the past six years, the REIA has been calling upon the Federal Government to respond to consumer and industry concerns about property investment marketers by more adequately regulating their activities.

12. It is the view of the REIA that the recent regulatory actions of the ACCC and ASIC in regards to property investment seminars have been too little, too late. Regulations which underpin existing legislation relating to adequate disclosure and declarations of conflict of interest should be examined to determine whether these need further strengthening or can be further extended to encompass property investment marketers.

13. The problems associated with property investment promoters can be summarised as including:

- a. provision of financial advice whilst not licensed;
- b. conflict of interest and non-disclosure of information relating to downside risk, interests in properties, or fees and commissions associated with their services;
- c. misleading and deceptive conduct;
- d. high fees and difficulties for consumers in obtaining refunds;
- e. characterisation of their activities, for instance as education seminars, in order to avoid regulation; and
- f. habitual use of high pressure selling techniques in order to induce investment decisions.

14. Each of these has significant potential to cause consumer loss and indeed, there is substantial evidence of consumer loss already available. The REIA believes that most of these problems are already addressed under existing legislation and regulations which have not been adequately or rigorously applied to the property investment seminar 'industry'. For example, the provision of financial advice (and the related conflict of interest and non-disclosure of information) is covered by the FSR Act, the Corporations Act and the ASIC Act, and there is substantial scope for ASIC to address offenders under this legislation. Likewise, misleading and deceptive conduct is addressed by the Trade Practices Act and the REIA believes that there may be scope for the ACCC to be more assiduous in addressing breaches of the Act by property investment either in response to consumer complaints or as a result of ACCC investigations prompted by their suspicion of misleading conduct. A range of State-based consumer legislation is in place to protect consumers, e.g. relating to cooling-off periods, refunds and guarantees.

15. Potential consumer detriment can be summarized as follows:

- a. consumers may be ill advised through group seminars and make financial commitments which are not appropriate to their individual circumstances;
- b. consumers may receive inappropriate financial investment advice from unqualified people;
- c. consumers may pay a purchase price for property which is above the market value as a result of misleading or deceptive conduct during the seminar(s), or as a result of subsequent marketing to the consumer;
- e. consumers may have difficulty obtaining refunds; and
- f. consumers may not be aware of non-disclosed information pertaining to the advice they receive.

16. It may be useful for legislation to be amended to provide more stringent definitions of 'property investment advice' comparative with alternative investment advice already covered under the FSR Act, but so that the 'high street' agent is not unduly affected.

17. There is a disparity between the regulation of investment advice about property and investment advice about financial products. There is also a significant disparity between the regulation of investment advice about property and the regulation of sale and management of property. Those with an ASF license suffer competitive disadvantage compared with unregulated property investment marketers. This competitive disadvantage also extends to licensed real estate agents. It is the REIA's view that investment regulation should focus on all asset classes and not only financial products. Likewise real estate regulation should focus on all those who provide real property services, not just real estate agents.

Property Investment Advice and Consumer Financial Literacy

18. There is some evidence to suggest that some groups of consumers are not well aware of the risks associated with property investment and financial products. Consumer and financial literacy in Australia has been the focus of research undertaken by the Commonwealth Government through its Consumer Financial Literacy Taskforce during 2004. The taskforce noted that while Australians spend over \$450 billion on goods and services each year (with \$156 billion being spent on dwelling sales alone in 2002-03), some population groups have particularly low consumer and financial literacy levels, making them vulnerable to scams, rorts and unmanageable levels of debt.

19. The ANZ Survey of Adult Financial Literacy (2003) and a University of NSW study, *Financial Services and Social Exclusion* (2001), have also studied the demographic and socio-economic factors relating to consumer and financial literacy. Groups identified as having low consumer and financial literacy levels included:

- a. households and individuals who have never had a secure job;
- b. elderly people who are part of a cash only generation;
- c. young people and households who have not yet made use of financial services;
- d. people on low incomes;
- e. women who have become single mothers at an early age;
- f. people and communities from non-English speaking backgrounds;
- g. regional and remote communities and depressed urban communities;
- h. consumers with disabilities;
- i. consumers with literacy difficulties; and
- j. indigenous consumers.

20. The ANZ survey found that in relation to investments, 85% of respondents knew that high returns on investments generally meant high risks. In relation to mortgages, 75% claimed to understand redraw facilities 'very well' or 'fairly well', with 61% claiming to understand home equity loans 'very well' or 'fairly well'. Groups experiencing difficulties included unskilled and farm workers, those with a low level of education, those with no occupation, and those aged 70 and over.

21. Respondents across all groups demonstrated a good understanding of the advantages and disadvantages of purchasing an investment property. Respondents were more likely to identify potential increases in property values as an advantage (59%) than a potential decrease as a disadvantage.

22. The REIA concludes from the available research that property investors are more likely to belong to population groups with reasonable consumer and financial literacy skills. It supports the recommendations of the Consumer and Financial Literacy Taskforce regarding strategies to enhance consumer and financial literacy amongst lower literacy groups.

Simultaneous Sales of Property and Financial Products Enabling the Purchase

23. It is the REIA's belief (and we believe this also reflects community expectations) that all those providing financial advice, including financial advice relating to property investment, should be qualified and licensed as required by ASIC. Importantly, all people selling real estate should be qualified and licensed as required by the State/Territory legislation. There should be no exceptions to these requirements.

24. The REIA approached ASIC for clarification of the FSR Act and in October 2002, ASIC formally advised REIA that there is essentially a "carve out" for real estate agents in that they may provide advice on property as follows:

- a. “The Financial Services Reform Act does not apply to real estate agents in their capacity of selling individual real property. The Act applies to financial products as defined under the Act. The definition of a financial product does not include real property. It does however include financial services provided in relation to products such as general insurance and managed investment schemes. Some of your members may be involved in advising or arranging general insurance or advising in relation to management investment schemes that primarily invest in property. Some of your members may also be caught where they are advising clients in relation to investment properties. Whilst advice in relation to the investment property is not caught, if they compare the potential return on such properties to other financial products like shares or management investments they may be caught as they may be regarded as providing financial product advice in relation to shares and managed investments. We have placed an FAQ on our website www@asic.gov.au which may provide further assistance. If you members are providing financial services in relation to financial products covered by the Act they will either need to be licensed or be authorised by a licensee.”

25. The REIA contends that property investment advisers, licensed either under the current financial services’ licensing regime or any proposed new legislation relating to property investment advice, should also be licensed as real estate agents if they are engaged in selling or managing real property. If they are not prepared to meet the rigorous requirements of real estate education and licensing, they should desist from selling or managing real property.

Possible Models for Reform of the Property Investment Advice Industry

26. **National Coverage through Uniform State and Territory Legislation.** The REIA does not support a new regulatory scheme, but an extension and enhancement of existing legislation at state and federal levels to ensure that property investment promoters are encompassed. These enhancements should include:

- a. Anyone selling property on behalf of another entity must be licensed as a real estate agent.
- b. Property developers selling their own properties must be licensed. All employees of developers who are engaged in real estate transactions should be registered to conduct those transactions.
- c. A mandatory warning statement must be included on the first page of all contracts instructing buyers to seek independent valuations and legal advice before signing – including contracts for private sales.
- d. Obligatory disclosure by real estate agents and property developers of any conflicts of interest, including relationships they have with service providers to whom customers are referred and any money, commissions, fees or other benefits they may receive as a result of the referral.
- e. All payments made to seminar spruikers and marketeers should be disclosed.
- f. Cooling-off periods should be required for goods and services provided as part of the property investment advice, including agreements that require financial commitments.
- g. There should be an obligation on property investment advisers to provide details of investment risk as well as investment potential.

27. The REIA strongly supports the principle that high standards of professional competency support consumer protection and provider protection. Consumer protection will be achieved in large part within a regulatory environment which promotes adequate training and education qualifications. Where possible, such legislation should be uniform across the States and Territories of Australia.

28. Any modifications to the current regulatory framework vis-à-vis property investment marketers should include minimum training and education qualifications, and fitness and propriety requirements. The standards for education and licensing for sale of property should be harmonised across all States and Territories.

29. There is a correlation between professional competence, education standards, and consumer protection. For example:

- a. Queensland's Office of Fair Trading notes a connection between improved consumer protection and enhanced professionalism, with a statement on its website that 'new laws were introduced in 2001 to improve consumer protection and enhance the professionalism of the industry'.
- b. International experience in the regulation of real estate practice also supports a connection between increased education requirements for real estate agents and consumer protection. The Association of Real Estate License Law Officials (ARELLO) reports that in July 2002 a new law went into effect in Oregon, USA, commonly called 'single licensing', which required all licensees to hold a broker's license and which conferred on them individual responsibility for their work product under license law. To accomplish this, the education required prior to sitting for the broker's license was increased dramatically, along with an additional post licensing course required during the first licensing period. Also, those licensees who were licensed as salespeople on the effective date had to take additional courses to remain licensed.
- c. Beginning in November 2002, the Oregon regulator noted a significant drop in the number of complaints received, from a monthly average of just under 50 complaints to the mid to high 30's. The trend held for over a year, even though the number of licensees remained stable and the real estate market continued to be a very healthy market. Several months ago, the number again dropped to just under thirty, and with the exception of June 2004, which had a slight increase, has remained constant. The Oregon regulator reports that anecdotally numerous licensees have commented on their increased awareness of the law gained by taking the additional courses. The primary motive of the legislation change was to 'raise the bar' of professional real estate practice in Oregon, and in the view of the Oregon regulator, it appears that the level of practice has improved.
- d. Similarly, research undertaken in New Zealand demonstrates the relationship between increased education standards and consumer protection succinctly. In 1996, the licensing requirement for New Zealand real estate agents was raised to AQF-equivalent Diploma level. A 2002 detailed review of real estate training and licensing conducted by the Real Estate Institute of New Zealand (REINZ) included research into the relationship between training of real estate professionals and consumer complaints. Statistics from the REINZ show a decline in complaints about agents following introduction of their revised and expanded educational programs.

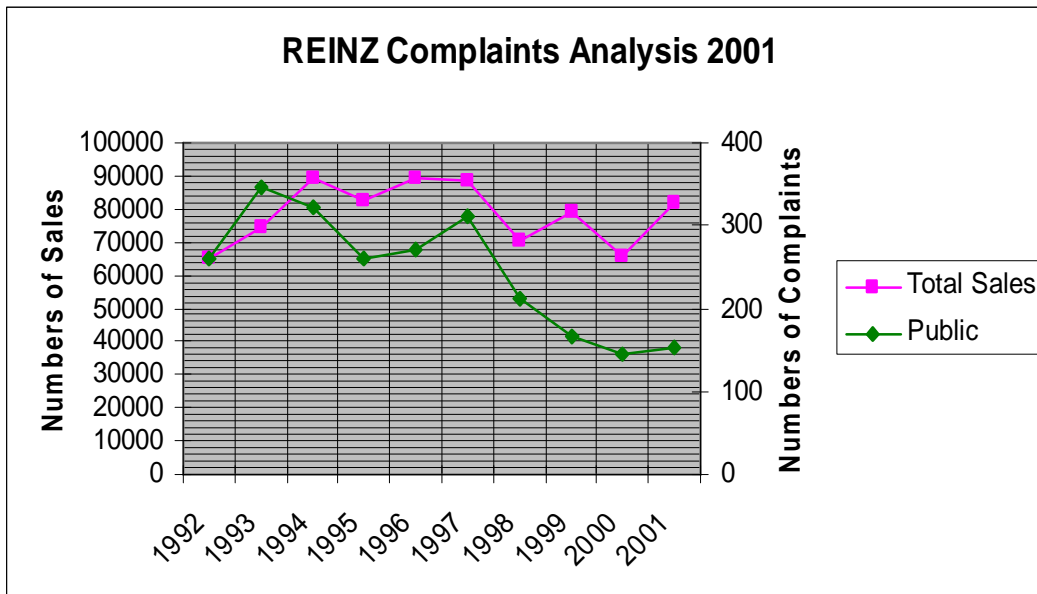


Chart 1: *REINZ Complaints Analysis 2001.*

- e. It can be noted from Chart 1 that whilst sales have essentially remained the same, public complaints dropped significantly from 1997 to 2001 following implementation of the Diploma for licensing in 1996 and a new range of professional development programs.

30. **Commonwealth Legislation.** As noted above, the REIA believes that existing Commonwealth legislation should provide coverage of the property market investment sector – however, the application of the existing legislation has been less than effective. For example, there is a widely-held view that financial services laws have only limited relevance to property investment advice, and property-related promotional and wealth creation training activities. This is argued on the basis of the way “making a financial investment” is defined in financial services legislation. While it is accepted that direct investment in property may result in the generation of a return, it is not seen as a return generated by the use of the investor’s money by another person. The REIA believes further legal study of this is warranted, particularly relating to the promotion of mezzanine lending schemes and ‘wrapping’ or vendor finance arrangements. Consideration should be given to changes to the legislation to include investment in all investment asset classes, including property.

31. Any new regulatory regime should be limited to retail investors, given that this is the consumer group which has experienced harm and/or loss. All forms of real property, including residential, commercial, retail and industrial property, should be covered. Further, new regulation should only relate to advice about the financing of property investment, given that many of the consumer/investor problems relate to the way investment finance is promoted.

32. Prohibitions on false or misleading representations, and unconscionable, misleading or deceptive conduct are prescribed by the Trade Practices Act and should be enforced. Anti-hawking provisions, as provided for in the ASIC and FSR Acts, should be enforced.

33. In addition, the REIA supports the preliminary recommendations to the Commonwealth Government by the Consumer and Financial Literacy Taskforce as a means of addressing information dissymmetry for consumers. These recommendations should be broadened to include a stronger focus on property investment (which receives less coverage than investment in other asset classes), and should be undertaken in conjunction with leading stakeholders, including the REIA.

34. **National Self Regulation.** The REIA considers that clarity in legislation through regulatory requirements is a more effective approach than either voluntary or mandatory industry codes. In particular, the REIA does not support voluntary codes – while it is highly likely that REIA members would endeavour to adhere to a voluntary industry code, there is no guarantee that rogue marketers who were not members of REIA would adhere to such codes. Property investment advice cuts across various industry sectors and professional and trade groups, and a proportion of promoters are ‘fly by night’ operators without an industry position or reputation to maintain.

35. Self-regulation and co-regulation have significant cost implications for industry associations. The costs of industry regulation and compliance are shifted largely from government infrastructure to an industry association that may represent most, but not all, of the industry.

36. There are clearly some benefits associated with industry organizations such as the REIA playing a lead role in developing the code of conduct for the industry they represent. The industry brings its expertise and insights into the marketplace and consumer requirements to code development. A sense of ownership within the industry, and therefore the potential for greater knowledge and compliance, would be cultivated.

37. However the enforceable nature of a code of conduct is questionable. While the industry association might be able to regulate compliance amongst its members, it cannot be responsible for non-members whose actions might reflect negatively upon complying members.

38. It is difficult to benchmark codes and measure outcomes. For example:

- a. would the measurement standard be compliance/non-compliance, or a ranking of quality of compliance?
- b. would different levels of compliance be required in different situations?
- c. does a requirement for measurability imply a related set of punitive actions for non-achievement?

39. There would be significant cost, time and administration implications for the industry body involved in any proposed code essentials such as:

- a. an industry reference committee;
- b. reporting requirements;
- c. consumer communication requirements;
- d. training requirements for the industry; and
- e. a code administration body.

40. Any consideration of a self-regulatory model would need to include some overlap with State and Commonwealth legislation. At best, there would be a complicated relationship between the three regulatory regimes.

Current Legal Processes Available in the Event of a Dispute

41. The REIA believes that there is considerable public dissatisfaction with the current processes available to consumers in dispute with property investment advisers. These could be alleviated by enhancements to legislation, as noted above, the establishment of a claim fund for consumers, and the establishment of a Commercial and Consumer Tribunal.

SUMMARY

42. The reputation of real estate businesses which comply with real estate and financial services regulations has been tarnished by the inadequately regulated activities of property investment marketers. Consumers have also suffered significant losses as a result of their activities.

43. It is the responsibility of both State and Commonwealth Governments to address this as a matter of urgency. However, to ensure that unscrupulous property investment advisers are not able to take advantage of regulatory variations between jurisdictions it is important that a nationally consistent response be implemented. Consumers must be afforded the same protections wherever they reside in Australia. Given that MCCA is the most appropriate forum for the Commonwealth and State and Territory Governments to resolve this issue in a nationally consistent fashion, the MCCA report on property investment must be finalised with the highest priority. This will provide an agreed basis upon which governments may then delegate responsibility and resources for an appropriate response to be implemented.

44. The REIA remains deeply concerned that property investment marketers are inadequately regulated and act outside the requirements of either Commonwealth financial services and trade practice legislation or State real estate legislation. The basic premise of the REIA is that all those providing investment advice should be regulated by financial services legislation, which may need to be better defined to address all asset classes, and not just financial products. Likewise, all those businesses providing real property services such as sales of investment properties should be licensed as real estate agents.

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