

# Chapter 5

## Referrals and independent advice

5.1 Consumer protection advocates urge potential investors to seek independent advice as a wise precaution before committing to a property investment venture, especially a complex scheme. In this chapter, the committee looks at the importance of independent advice and how this can be compromised. The committee considers the payment of commissions and advice given by lawyers and accountants who often had pre-existing relationships with Market First and 21<sup>st</sup> Century Group and benefitted from referrals.

### Commissions

5.2 Mr McIntyre informed the committee that he received between 17 and 20 per cent commission for selling options.<sup>1</sup> The committee has received evidence that Mr McIntyre may have received commissions much higher, but he insisted that 21<sup>st</sup> Century received approximately 20 per cent.<sup>2</sup> Mr Kingsley, Property Investment Professionals of Australia, was curious to learn about the levels of commission that were being paid. He explained:

It is something that is debated heavily within the property investment industry around what is an appropriate level of commission that needs to be paid. I would suspect 17 to 20 per cent is excessive in the upper end of the scale with regard to what would be an appropriate level of remuneration for professional advice in our field.<sup>3</sup>

5.3 In his view, between two and five per cent would be a reasonable commission. He knew of practitioners offering more than five per cent—between five and 10 per cent but even these were 'very, very big numbers'. He observed:

If I was to buy a \$500,000 investment property and I was good enough to convince you it was a great investment, I could potentially take a \$50,000 commission.<sup>4</sup>

5.4 In this regard, it should be noted that as the principal marketer for Midland, Mr McIntyre suggested that 21<sup>st</sup> Century would have received commissions of between \$2 and \$3 million.<sup>5</sup>

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1 *Committee Hansard*, 30 September 2015, p. 19.

2 Mr Nejat Mackali, correspondence to the committee, 22 October 2015 and Mr Jamie McIntyre, correspondence to the committee, 25 November 2015.

3 *Committee Hansard*, 30 September 2015, p. 57.

4 *Committee Hansard*, 30 September 2015, p. 57.

5 *Committee Hansard*, 30 September 2015, pp. 23 and 25.

5.5 In its current inquiry into forestry managed investment schemes (FMIS), the committee has identified two areas of concern associated with high fees and commissions—the incentive for an adviser to recommend a product for personal reasons (better remuneration irrespective of the merits of a product); and the siphoning of funds away from the investment. With regard to commissions exercising a perverse influence, the committee has noted that the payment of commissions has a tendency to compromise that advice.

5.6 Evidence from the FMIS inquiry indicates that the Future of Financial Advice (FOFA) reforms, by removing conflicted remuneration, may well have remedied one of the most pernicious incentives underpinning poor financial advice. However, without prejudging the findings of the FMIS inquiry, the committee makes the preliminary observations that commissions have the potential to corrupt advice and it is important to ensure there are no loop holes in legislation that would allow any form of incentive payments to creep back into the financial advice industry. This same observation about the propensity for commissions to compromise advice applies with equal force to investment in property.

#### *Committee view*

5.7 As long as commissions remain an important source of remuneration for the promoters of land banking schemes, particularly the payment of high commissions and other inducements to sell the product which override the interests of the investor, the potential for poor investment advice in this industry will persist.

#### **One stop shop: 'independent' legal and financial advice**

5.8 In many cases, it appears that Market First and 21<sup>st</sup> Century Group referred investors to service providers for advice on financial and legal matters who had an arrangement with the operators and promoters of the land banking schemes. ASIC informed the committee that it had identified 'many instances' where the operator or promoter of a scheme had referred investors to other professional service agents associated with those marketing or operating the scheme. It cited the case of Midland Hwy where the administrators have raised concerns as to a conflict of interest by a lawyer who acted for both the operators of the scheme and the investors.<sup>6</sup>

5.9 By failing to disclose this relationship, the service providers allowed investors to assume they were getting independent advice.

#### *Slater and Gordon Lawyers*

5.10 As discussed earlier, many investors in Market First's projects were referred to Mr Zuchowski, who was then employed as a lawyer at Slater and Gordon Lawyers and advised 197 clients on the Veneziane or Foscari projects.<sup>7</sup> Alerted by the volume

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6 ASIC, answer to written question on notice No. 15.

7 *Committee Hansard*, 30 September 2015, p. 48.

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of Market First referrals, Slater and Gordon became concerned about the quality of Mr Zuchowski's advice and that he may have had a conflict of interest.<sup>8</sup>

5.11 In his legal advice to clients, Mr Zuchowski addressed the risks and complexities around the investments 'to some extent' and advised clients that the option fee was non-refundable; and, once paid, became the property of the grantor to do with as it saw fit.<sup>9</sup> Nonetheless, Slater and Gordon reported that Mr Zuchowski did not follow Slater and Gordon's established risk management processes: Mr Zuchowski did not log his work with the Professional Standards and Risk team or consult his peers in relation to the substantive advice he provided to clients.<sup>10</sup> Slater and Gordon told the committee that the adequacy of Mr Zuchowski's advice should be judged by others, not the firm.<sup>11</sup>

5.12 Mr Zuchowski's potential conflict of interest appears, in part, to derive from a personal relationship. As part of its investigations, Slater and Gordon discovered that Mr Zuchowski is the brother-in-law of Mr Darren Eliau, Principal Lawyer at Evans Ellis Lawyers. Evans Ellis Lawyers have been at the centre of a number of land banking schemes, including, in this case, acting for the vendors.<sup>12</sup>

5.13 On a number of occasions in late 2013 and early 2014, Slater and Gordon wrote to clients, who were involved in Market First's projects, outlining several concerns about the Market First developments and advising them to seek independent legal advice on those matters.<sup>13</sup> Market First contacted many investors directly, telling them that Slater and Gordon could not handle the volume of referrals they were receiving and suggesting that investors transfer their files to SK Lawyers.<sup>14</sup> For instance, Mr Guy was told by Market First that 'Slater and Gordon was not capable of dealing with the amount of enquiries and paperwork that was associated with Market First generating the sale'.<sup>15</sup> Also, Mr Hayne reported receiving phone calls from Market First, informing him that Slater and Gordon 'were not doing us any good anymore and we have to change to SK Lawyers'.<sup>16</sup>

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8 Ms Sharon Taylor, General Manager, Professional Standards and Risk, Slater and Gordon, *Committee Hansard*, 30 September 2015, p. 48.

9 Slater and Gordon Lawyers, answer to question on notice, 2 December 2015, p. 2.

10 Slater and Gordon Lawyers, answer to question on notice, 2 December 2015, p. 2.

11 Ms Sharon Taylor, General Manager, Professional Standards and Risk, Slater and Gordon, *Committee Hansard*, 30 September 2015, p. 45.

12 Ms Sharon Taylor, General Manager, Professional Standards and Risk, Slater and Gordon, *Committee Hansard*, 30 September 2015, p. 46.

13 Ms Sharon Taylor, General Manager, Professional Standards and Risk, Slater and Gordon, *Committee Hansard*, 30 September 2015, p. 43; Slater and Gordon Lawyers, *Submission 147*, Attachment 1.

14 Slater and Gordon Lawyers, answer to question on notice, 2 December 2015, pp. 2-3.

15 Mr Jim Guy, *Committee Hansard*, 30 September 2015, p. 37.

16 Mr Trevor Haynes, *Committee Hansard*, 30 September 2015, p. 39.

5.14 Despite urgings from Slater and Gordon to seek independent advice, most clients continued to follow Market First's referrals. Of the requests for Slater and Gordon to transfer files, 18 clients sought independent advice from Holding Redlich (who were nominated to provide legal advice by the Law Institute of Victoria) and 91 sought legal advice from firms recommended by Market First (namely SK Lawyers, Network Legal & Associate and Summit Law).<sup>17</sup>

5.15 The committee received evidence revealing how promoters encouraged potential investors to seek legal advice from a recommended law firm. At one of its investment seminars, a 21<sup>st</sup> Century Property Direct spruiker told potential investors that a 'bulk price' had been struck with Bazzani Scully Brand lawyers, so that it would cost 21<sup>st</sup> Century Group members only \$600 per options agreement for legal advice.<sup>18</sup> While potential investors were told they could choose to receive legal services from another law firm, the 21<sup>st</sup> Century Property Direct spruiker repeatedly stated that it would likely cost potential investors a significant amount of money—\$2,000 to \$5,000 per options contract—if they went to another law firm.<sup>19</sup>

5.16 Further, the spruiker indicated that most solicitors would not understand options agreements, and even solicitors willing to take on the work would charge substantially higher fees because they would need to read and get across all of the details in the potential investor's contract.<sup>20</sup> With the emphasis on the efficiency and cost benefits of relying on the recommended law firm, it is not surprising that many investors would have considered using the services recommended by the promoters of the schemes. The committee makes no judgment as to the quality of the advice provided by Bazzani Scully Brand lawyers, but this example illustrates the method used by spruikers to direct investors to preferred service providers.

5.17 Many of the investors in Market First and 21<sup>st</sup> Century Group's land banking schemes used external accountants recommended by the promoters of the schemes. ASIC informed the committee that approximately 60 per cent of investors in land banking schemes invested through SMSFs. Importantly, ASIC noted:

The promoters or scheme operators refer investors to particular companies to establish the SMSFs.<sup>21</sup>

5.18 For example, in promotional material, Market First noted:

Many Market First Members choose to invest in property through their Self-Managed Super Fund.

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17 Slater and Gordon Lawyers, answer to question on notice, 2 December 2015, p. 3.

18 Ms Grazyna Monka, *Submission 148*, around 60 minutes into DVD no. 3.

19 Ms Grazyna Monka, *Submission 148*, around 60 minutes into DVD no. 3.

20 Ms Grazyna Monka, *Submission 148*, around 60 minutes into DVD no. 3.

21 ASIC, answer to question on notice, 30 November 2015, p. 11.

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As a member you can be introduced to a qualified advisor to help you do this. Your advisor can also help you set up a Self-Managed Super Fund, for very little cost, if you decide you want one.<sup>22</sup>

5.19 Typically, the investors had little actual contact with lawyers and accountants other than to sign a standard document. Ms Monka, for example, told the committee that she only received legal advice about her investment in the Moira Park Green City development after the investment was finalised and the money had already been transferred.<sup>23</sup>

### *Committee's view*

5.20 Referrals by a company promoting a scheme to other service providers for expert advice may be a genuine attempt by the promoter to assist their client in finding such expertise. But in some cases, it appears that, because of links or relationships with the developer or promoter of the scheme, the independence of such advice may be called into question. The committee is particularly concerned about the advice given by several lawyers and law firms to investors in the schemes, as well as the role played by some law firms in the operation of land banking schemes (described at various points throughout this report). Most of those lawyers appear to be based in Victoria.

5.21 A common thread running through the land banking schemes investigated by the committee was that the promoters of the schemes referred investors to lawyers, accountants and lenders with whom they had a potential conflict of interest because of their pre-existing (and often intertwined) business relationships. In some cases, the professionals did not appear to alert their clients to risks associated with the projects and seemed more to facilitate a transaction in the interests of the promoter or developer and not their client. Their advice could not be seen as independent.

### **Recommendation**

**5.22 The committee recommends that the Victorian Legal Services Commissioner and Legal Services Board (and, where appropriate, other state and territory legal professional bodies) investigate thoroughly the conduct of lawyers involved in providing advice to investors in the land banking schemes considered in this report, as well as those lawyers who provided advice, and controlled trust accounts, for the operators of the schemes.**

### **Recommendation**

**5.23 The committee recommends that Consumer Affairs Victoria investigate whether Market First and/or other parties, including lawyers, breached the**

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22 Market First, *'Secure Your Wealth' Property Investment System*, attachment to *Submission 150*, p. 41.

23 Ms Grazyna Monka, *Committee Hansard*, 30 September 2015, p. 8.

**requirements in the *Sale of Land Act 1962 (Vic)* in regards to off-the-plan contracts of sale for the Foscari and Veneziane developments.**

## **Conclusion**

5.24 All investment strategies have risks, and it is important to understand the risks to determine whether they are acceptable when considered as a part of an investment strategy. The committee strongly suggests that potential investors seek advice from professionals who are independent and not recommended by spruikers: licensed financial advisers (who are listed on ASIC's financial advisers register); lawyers who are recommended by state and territory legal profession bodies; qualified accountants; and brokers who disclose their ownership and commission structures. During discussions with these professionals, potential investors should specifically ask for the risks associated with the product or schemes to be clearly outlined.