PROTECTION FOR MORTGAGE INVESTORS

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I. LOST INVESTMENTS

In recent years many persons have experienced the anguish of the loss of investments. Obviously the nature of these investments and the circumstances of their loss vary enormously. Purchasers of shares find that the enterprise in which they are shareholders has failed absolutely. Generally they appreciate that risk. Others seek to avoid the risk of failure of an enterprise by investing through the medium of a secured loan. If the security is land then that transaction will commonly be by way of mortgage. But the investor's funds may not appropriate for a single mortgage transaction and the investor may not have access to a suitable borrower/mortgagor. The investor may seek an intermediary to handle the investor's funds. Traditionally the Australian depositor at a savings bank or a building society viewed the deposit as fulfilling a similar function. The bank or building society was to take funds from all depositors and invest them in loans secured by mortgage.

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The purchaser of shares does face some risk of misappropriation of his or her funds by the intermediary handling the funds. These risks are given reduced emphasis because the medium of investment involves marked risks. Similarly the mortgage investor runs some risks because of the medium of the investment. Particularly if the property over which the mortgage is taken is a speculative commercial venture very heavy losses may be experienced by the mortgage investor. Even land prices, particularly urban fringe land prices, are affected by cycles of the economy. However a mortgage investor would normally consider that dramatic losses because of declining value of the mortgage property are unlikely. On the other hand although the bank and building society depositor may feel protected by secured lending, that depositor's relationship with the institution is one of debtor and creditor and the depositor has no proprietary claims against any assets of the institution. Moreover the depositor has little control over the activities of the institution.

The range of investment techniques for an investor seeking a secured investment is considerable. Various companies offer what amount in essence to unit trusts: the investor holds a proportionate share in property or specified types of property managed by the company. In some instances these investments have not provided a promised return to the investors. Their regulation depends on the prescribed interests provisions of the Companies Code.[1] On the other hand an investor may prefer more individual transactions arranged through a smaller intermediary, often a professional person such as an accountant, solicitor or in South Australia and Western Australia a land broker. For a solicitor or land broker this business is significant in carrying with it the fees on the land transaction documents.

Clearly substantial amounts of other people's money provide temptation. Lawyers are screened as to the standards of probity before entry into their occupation but accountants have not been a traditionally regulated occupation and the activity of investment adviser has not been the exclusive domain of any occupational group or groups. In any event standards of honesty are difficult to test in advance so that further regulation of persons who deal with money belonging to others is common.[2] This regulation normally includes a requirement for the establishment of separate trust accounts and the regular auditing of these accounts.

The requirement that particular classes of persons deposit money into trust accounts has commonly been associated with the provision of some guarantee for persons who suffer loss through the misappropriation of those funds. For a long time trust accounts held at banks did not earn any interest though the persons responsible for the accounts no doubt had a considerable bargaining weapon in dealings with the bank - a weapon of personal advantage rather than

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1 Companies Code s.5, see H.A.J. Ford, *Principles of Company Law* (5th ed., 1990), 359-365.

2 See A.P. Moore and A.A. Tarr, "General Principles and Issues of Occupational Regulation" (1989) 1 *Bond Law Review* 119 123-4.

advantage for those beneficially entitled to the money. But alongside general increased community consciousness of the significance of interest the funds were seen as a source of income to protect investors and to support other socially valuable goals. In the pre-computer days costs of calculation and distribution of interest to those beneficially entitled to the funds were considered to outweigh the benefits to those beneficiaries of such a distribution.

Persons suffering loss through misappropriation of trust monies were given access to guarantee funds. On the other hand protection for claims for negligence or similar default was offered through, sometimes compulsory, indemnity insurance. Insurance may not have been regarded as appropriate for protection against defalcation as it would infringe the policy forbidding insurance against criminal activity. On the other hand it is not difficult to frame the insurance cover so that it relates to the person dealing with the defaulting party rather than the defaulting party.[3]

A further distinction in terms of the risk undertaken is commonly drawn between a guarantee against fraud as opposed to one against economic mismanagement. Again the investor is said to accept risks associated with mismanagement and the same need for a guarantee is said not to be present. However in practice the distinction cannot be so clearly drawn. Moneys are often misappropriated not for personal benefit but to cover over past mistakes. Once started the process of juggling funds is never ending.

Higher returns on investments are said to reflect the increased risks associated with those investments. The share investor is therefore responsible for making his or her own assessment of the economic potential of the subject matter of the investment. Part of the attraction of particular companies or firms is their financial stability. Similarly the choice of an intermediary to arrange a mortgage investment will in part reflect an assessment of that intermediary's standing. Again higher standing may be reflected in higher charges.

The provision of a guarantee fund at least to some extent removes risks associated with the choice of an intermediary. The competitive position of the more careful or more experienced practitioner is thus weakened by such a system. On the other hand all practitioners benefit from the increased confidence provided by the system. The maintenance of confidence is important in a free market economy to encourage investors. The continued presence of these investors is vitally important to potential borrowers. It is not that long ago that Australian private banks were trading banks and that government savings banks had strict lending criteria. Private mortgage funds were the only source of finance for the purchase of an established house.

This article is concerned to examine a spate of defaults by South Australian land brokers during the 1980s. The constant changes to legislative regulation and guarantees for investors are remarkable. Subsequent events in Victoria in

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3 Such a scheme has been adopted in the travel industry. See J. Goldring, L.W. Maher and J. McKeough, *Consumer Protection Law in Australia* (3rd ed., 1987), 183-196.

particular cause surprise at the fact that soon after news of the major collapse the South Australian Attorney-General wrote to all investors undertaking that the government would do all in its power to ensure they ultimately received back one hundred cents in the dollars. At the time investors with one defaulter were in fact only guaranteed by legislation approximately eight cents in the dollar!

II. LAND BROKER DEFAULTS

The 1980s saw a number of defaults by South Australian land brokers. The major insolvencies were of the Swan Shepherd group of companies in 1980, Field in 1985, Hodby in 1986, Schiller in 1987, Nicholls in 1988 and Winzor in 1989. The succession of amendments to the legislation was connected to the experience relating to these defaults. The promise by the South Australian Attorney-General that the government would seek to provide as far as possible a one hundred cent in the dollar return of capital investment was made in relation to Hodby and Schiller.

The Chairman of the Commercial Tribunal prepared a paper addressed to all claimants against the Agents Indemnity Fund in respect of Hodby and Schiller. That paper was prepared as an information document preliminary to a hearing of the Tribunal at which the Commissioner for Consumer Affairs was to present submissions common to all claims. The paper indicated that the Attorney-General's promise could not be met without amending legislation. The submissions accepted the Chairman's conclusion that there were insuperable difficulties. The principal difficulty was that a significant limit on payments out of the guarantee fund operated until 18th February 1988 and most of the claims made against Hodby and Schiller were lodged before that date. The limit was that payments with respect to any one defaulting broker could not exceed 10% of the balance of the guarantee fund.

The extent of the defaults can best be gauged from the summary provided in the Parliamentary Debates:

(1) The last audited accounts of the Agents Indemnity Fund were the accounts made up to 30 June 1988.

(2) The balance of the fund on that date (to the nearest one thousand dollars) was $5.944 million.

(3) The balance in the fund as at 31 August 1988 was $6.5258 million (subject to audit).

(4) The income of the fund from interest on trust accounts is approximately $250,000 per month.

(5) Based on the present balance, the fund itself earns interest of approximately $80,000 per month.

(6) The total amounts involved in claims in the Hodby and Schiller matters are:

R D Hodby.....	8.379 million
T R Schiller.....	2.314 million
	$10.693 million

The total amounts validated by the Commissioner for Consumer Affairs in his recommendations to the tribunal are:

R D Hodby.....	7.793 million
plus interest to 30 September 1988	.152 million
T R Schiller.....	1.723 million
	$9.668 million

(7) Other pending claims for compensation from the fund are as follows (figures in the column headed `Validated' are those recommended by the Commissioner for Consumer Affairs):

	Claims	Validated
	$	
Swan Shepherd	4,000,000.00	672,776.49
Warner 106,738.41	not known	
Nicholls (a recent land broker's default)	None yet made	-------

In addition, there is a further $282,784 payable to claimants in respect of defaults by L A Field if those claimants are to receive 100 cents in the dollar.

(8) It may take years to determine how much will be received by Hodby creditors from the Official Receiver. The current expectation is that creditors will eventually receive between 40 per cent and 45 per cent of their claims. There may be an interim payment of 25 per cent to 30 per cent in October 1988. The total amount available for distribution to Hodby creditors is expected to be $3 million or more. In the case of Schiller's bankruptcy, it is not yet known whether a distribution will be made; if it is, it is likely to be minimal.

(9) In summary, the total amount of present claims and other amounts payable out of the fund is $10.8 million as against a present balance of $6.5 million. Even after the bankruptcy recoveries are completed, there is likely to be a shortfall of between $1 million and $2 million.[4]

Prior to the amendments most of the claims were subject to the ten per cent rule. The ten per cent was the maximum which could be applied to the creditors of any one defaulter. The application of this rule would have meant that the Hodby creditors would have been entitled to 7.8 cents in the dollar and the Schiller creditors 35 cents in the dollar.

The result of 1988 amendments was to allow the whole of the fund to be paid out to cover the claims of the creditors. Even then there was a shortfall and the procedures of the Act allowed for further ex gratia payments at the discretion of the Minister as the funds swelled. The Attorney-General indicated an intention to allow further payments until the one hundred cents in the dollar goal had

4 South Australia, *Parliamentary Debates*, 5th October 1988, 846.

been achieved. In fact Hodby claimants received 35.3 cents in the dollar from the Official Receiver and on the balance of claims (ie, after deducting this payment) an immediate 60.0 cents in the dollar from the guarantee fund. The Schiller claimants also received an immediate 60.0 cents in the dollar from the guarantee fund.[5]

Allegations of various improprieties was made in the course of the parliamentary debates on the 1988 amendments.[6] Firstly it was alleged that at least for two years Hodby failed to lodge audit reports with the Department of Public and Consumer Affairs but continued to hold a valid licence. The possibility of government liability in negligence was thus raised and may have been an incentive to ensure the 100 cents in the dollar return. Secondly Hodby and Schiller had various arrangements for the receipt of money. Money came through associated companies for the purpose of investment mortgage and those monies did not go through the trust account. Schiller's wife invested in her name some of the monies entrusted to Schiller.

The liability of the indemnity fund was altered to deal with some of these problems. First, the definition of agent was broadened to include any land agent or land broker acting as a mortgage financier. Consequently no argument could be mounted that such monies were not received in the course of the agent's business as an agent and were not subject to the accounting and indemnity requirements. Secondly, the definition of agent was expanded to include a mortgage financier who was an associate of an agent. Thus any default by that associate was a default by an agent and subject to the indemnity provisions.

III. REGULATION OF LAND BROKERS

Land brokers are persons who in South Australia and Western Australia share with lawyers the monopoly in respect of the conveyancing business. In South Australia this monopoly is expressed as the statutory rule that no person shall prepare for fee or reward an instrument relating to any dealing with land unless that person is licensed as a land broker or legal practitioner.[7] The definition of those things that can only be done by a land broker (or a legal practitioner) does not amount to an exhaustive statement of all those things which a person who is a licensed land broker may do in the course of his or her business activity. Nonetheless the essence of the business of a land broker is the preparation of documents relating to dealings in land.

The process of occupational regulation of land brokers in South Australia has been subject to much change in recent years. This change has been as to both fundamentals and details of the process. Prior to 1973 the regulatory process

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5 Commission for Consumer Affairs (S.A.), *Annual Report 1988-89*, 26.

6 South Australia, *Parliamentary Debates*, 5th October 1988, 845-858.

7 Real Property Act 1886 (S.A.) s.274.

had been relatively simple and unchanged. Under s.271 of the Real Property Act 1886 (S.A.) the Registrar-General appointed under that Act was empowered to licence fit and proper persons to be land brokers. The Registrar-General was required to obtain a bond and two sureties from any licensed broker. From 1936 the bond was £500 and the sureties £250 each. In 1960 the amount of the bond was raised to £1,000 and the sureties to £250 each. The bond was commonly provided by a relatively cheap insurance policy. This system was repealed by the Real Property Act Amendment Act 1972 (S.A.).

The replacement licensing system linked land brokers with land agents. The legislation introducing this new system had many aims - a new regime for land agents was one of them, as was a system for disclosure and cooling-off in relation to land transactions.[8] The principal concern with respect to land brokers was with the relationships between land brokers and land agents. A conflict of interest was feared to arise from a close connection between a land broker and a land agent. A land broker's duty toward the broker's client might be to advise of deficiencies of a proposed transaction whereas the relationship with the agent favoured consummation of the transaction because of commission entitlement. A severance of land broker-land agent relationship was sought. Whether or not incidentally to that objective, a new licensing system for land brokers was introduced.

The new licensing system was introduced by the Land and Business Agents Act 1973 (S.A.). That Act established both a Land and Business Agents Board[9] and a Land Brokers Licensing Board.[10] The brokers board consisted of the Registrar-General, a legal practitioner, a licensed land broker and two other nominees of the Minister.[11] The qualifications for a licence were that the person was over the age of eighteen years, a fit and proper person to be licensed, and the holder of either a previous licence or of prescribed qualifications.[12] The bond and sureties were no longer required.

The Land Brokers Licensing Board was in turn abolished by the Land and Business Agents Act Amendment Act 1985 (S.A.). The grant of licenses and the hearing of disciplinary actions was entrusted by this Act to the Commercial Tribunal.[13] The title of the Land and Business Agent Act was changed in 1986 to the Land Agents, Brokers and Valuers Act 1973 (S.A.) (hereafter "the 1973 Act"). Some of the administrative functions formerly exercised by the brokers board were transferred to the Commissioner for Consumer Affairs. In May 1987 a two person occupational licensing unit was established by the Commissioner for Consumer Affairs. This unit was responsible not only for

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8 S.K. Trenowden, *South Australia's Consumer Laws* (1989), Chapter 8.

9 Land and Business Agents Act 1973 (S.A.) s.7.

10 Land and Business Agents Act 1973 (S.A.) s.49.

11 Land and Business Agents Act 1973 (S.A.) s.49(2).

12 Land and Business Agents Act 1973 (S.A.) s.57.

13 Established by the Commercial Tribunal Act 1982 (S.A.).

licensing matters with respect to land agents and land brokers but also builders, second-hand motor vehicle dealers, travel agents and commercial and private agents.[14]

IV. TRUST ACCOUNTS AND COMPENSATION

Although from 1973 to 1985 there were separate licensing authorities for land agents and land brokers, there was a single set of rules relating to the handling of clients' money. In turn there was a single fund which was the source of compensation for clients of land agents and land brokers for some financial misdeeds. Part VIII of the 1973 Act is headed "Trust Accounts and the Consolidated Interest Fund". In Part VIII the term "agent" was defined to include a licensed land broker.[15] Agents and brokers were required to pay all money received by them as agents into a trust account.[16] Agents and brokers were required to earn interest with respect to trust account monies[17] and the interest was to be paid to "the Board". "The Board" was required to maintain an account entitled the "Consolidated Interest Fund". For the purposes of Part VIII even in relation to money provided by land brokers "the Board" was the Land and Business Agents Board.[18] The consolidated interest fund was to be held and applied for the purpose of compensating persons who suffered loss from a fiduciary default with respect to trust monies held by an agent or broker.[19]

The key terms relevant to the handling of trust money were to be changed by amendments in 1985, 1986, 1987 and 1988. The 1985 amendments related to the administrative consequences of the abolition of the Land and Business Agents Board and the Land Brokers Board. Whilst most of the functions of the Boards were transferred to the Commercial Tribunal some administrative duties were entrusted to the Commissioner for Consumer Affairs. These duties included the maintenance of the Consolidated Interest Fund, which was retitled the Agents' Indemnity Fund. The 1986 and 1987 amendments were attempts to refine (in parts quite substantially) the system. The 1988 amendments came about because substantial land broker defaults exposed aspects of the system which the government found unacceptable. References in this article to amendments are to the year of the amending legislation; as we have already seen one difficulty in the Hodby and Schiller cases was the time amending legislation came into operation and the 1986 legislation was for the most part operative from 18th February 1988.

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14 Commissioner for Consumer Affairs (S.A.), *Annual Report 1986-87*, 23.

15 Land and Business Agents Act 1973 (S.A.) s.62.

16 *Ibid.*

17 Land and Business Agents Act 1973 (S.A.) s.65.

18 Definition of "the Board" in s.6(1) of the Land and Business Agents Act 1973.

19 Land and Business Agents Act 1973 (S.A.) s.68(3).

The first term whose change of definition should be noted is that of "agent" for the purposes of Part VIII. It 1973 definition has already been quoted.[20] In 1986 agent was defined to include "a land broker and any other person who carries on business of a prescribed class". In 1987 "agent" was defined to include: "(a) a land broker; (b) a financier that is an associate of an agent or a land broker; (c) a person who carries on a business of a prescribed class". In 1988 paragraph (b) was changed to read "a mortgage financier". "Mortgage Financier" was then defined as "(i) an agent or land broker or (ii) an associate of an agent or land broker" who received money from another on the understanding that the money would be lent to a third person on the security of a mortgage. Regulations were introduced concerning the operations of mortgage financiers.

Our second concern is the term "trust monies". In 1973 "trust monies" were defined as "monies received by an agent or a land broker to which he is not wholly entitled both at law and in equity and which he is required to pay into a trust account pursuant to Part VIII of this Act".[21] In 1986 the definition was transferred to Part VIII so that the peculiar definition of "agent" was incorporated into it.[22] "Trust money" was defined "money received by an agent, in the course of business as an agent, to which the agent is not wholly entitled both at law and in equity". In 1987 "trust money" was redefined as "money in the possession or control of a person who is not wholly entitled to it both at law and in equity".

Thirdly, the term "fiduciary default" was also subject to this process of redefinition. In 1973 it meant "any defalcation, misappropriation or misapplication of trust monies in the charge of an agent or firm of agents, whether committed by the agent or firm of agents, his or their employee, or any other person".[23] In 1986 it was defined in relation to an agent to mean "any defalcation, misappropriation or misapplication of trust money in the charge of: (a) the agent; (b) a firm of which the agent is a member; or (c) a company of which the agent is a director, whether committed by the agent, an employee of the agent or of the company or by any other person". The 1987 definition became "a defalcation, misappropriation, or misapplication of trust money occurring while the money is in the possession or control of: (a) an agent; or (b) a firm of which an agent is a member".

By this point the dominant impression is of more crossings-out and startings-again than the most indecisive school child. However any claims for compensation depend upon these definitions. Compensation is available to persons who suffer actual pecuniary loss from a fiduciary default. A fiduciary default is a defalcation, misappropriation or misapplication of trust money in

20 Land and Business Agents Act 1973 (S.A.) s.6(1).

21 *Ibid.*

22 Land Agents Brokers and Valuers Act 1973-86 (S.A.) s.62(1).

23 Land and Business Agents Act 1973 (S.A.) s.68(1).

the charge of an agent of an agent's firm. The changes to the definition of fiduciary default are minor but that definition in turn incorporates the definitions of agent and trust money.

The significant change in the definition of agent is the expansion of the term in 1987 to include financiers and then the definition of mortgage financiers in 1988. The expansion did not incorporate all persons receiving money to be lent out on mortgage but only such persons who were agents or associates of agents. Mortgage financier agents were regulated simply because of their capacity as agents though the change may have helped to indicate that mortgage financing was part of the business of an agent. Importantly mortgage financier associates were deemed to be agents. Thus activities of a spouse were subject to the regulatory framework.

The 1973 definition of trust monies can be given meaning by reference to what money was required by Part VIII to be paid into a trust account. The requirement applied to money received in the capacity as an agent. Thus the relationship of an investment service to the business of an agent is raised. If that service is not regarded as part of the business of an agent, then money received for that service is not received in the capacity of an agent and the trust money procedures do not apply to it. The indemnity was given only with respect to defalcations of trust money. The 1986 amendment preserved this capacity of an agent qualification. The 1987 amendment removed the qualification. The definition of trust money is then so broad that the weekly shopping money entrusted to an agent by a spouse might well be regarded as trust money.

The term actual pecuniary loss has been interpreted by Olsson J. in the South Australian Supreme Court as limited to the capital actually invested. In *Schofield v. Consolidated Interest Fund*[24] the applicants had deposited money to their credit in a licensed land broker's trust account. This broker was Field, one of those whose default has been listed earlier. Specific instructions were given as to the investment of the money. Field misapplied the money for his own purpose. The applicants claimed against the Consolidated Interest Fund. The dispute was as to their entitlement to the interest they would have received had the money been invested as instructed. Justice Olsson held that the loss could not be described as an "actual pecuniary loss". The loss was not simply some inchoate or non-quantified element of damage but a specific, defined, crystalised money amount which would have been earned had the instructions been honoured. However the word "actual" indicated an exclusion of recovery for economic loss so as to limit recovery to the reimbursement of the actual subject matter of the fiduciary default.

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24 (1988) 49 SASR 456. See also *Dabcol Pty Ltd v. Law Institute of Victoria* [1979] VR 393.

On the other hand fiduciary defaults are not limited to misappropriations for the personal benefit of the agent. In *Wong v. Agents' Indemnity Fund*[25] the dispute related to some $135,000 entrusted by the applicant Wong to the defaulting broker, Schiller. This money was invested in a mortgage over a property at Port Lincoln. In September 1986 the property was transferred to Schiller and another person for an expressed consideration of $25,000. At the same time a mortgage was registered for $240,000 the mortgagees being Wong (as to $135,000), Schiller's wife (as to $60,000) and Schiller (as to $45,000). In early 1987 after the collapse of Schiller's business, enquiries revealed that only minor building work had been done on the site and the property was worth about $30,000.

Judge Noblet in the Commercial Tribunal held that a defalcation meant a monetary deficiency as a result of a breach of trust. Clearly Schiller stood in a fiduciary relationship to Wong. The mere fact that the trustee did not disclose a personal half-interest in a property which he was recommending to be used as security for an advance was sufficient to constitute a breach of trust. The trustee concealed information highly relevant to the investment decision. The loss suffered was therefore an actual pecuniary loss arising from a fiduciary default.

Compensation is not however available for all actual pecuniary losses resulting from fiduciary defaults by agents in the handling of trust money. Claims for compensation for such losses may be made against the guarantee fund. From 1973, the amount which might be applied towards satisfaction of all claims made in respect of the fiduciary defaults of any particular agent could not exceed ten per cent of the balance of the consolidated interest fund.[26] The balance was that disclosed in the accounts of the fund last audited before the proposed application of monies towards satisfaction of the claims. This proportionate settlement of claims in turn depended on a system of administrative notice calling for all claims in respect of a particular agent. The ten per cent rule was removed in 1986 but claims were limited to the amount of the fund. That limit posed greater administrative problems as the first claimant could theoretically take the whole of the fund. The Commissioner for Consumer Affairs was therefore given a discretion to defer payment of entitlements for a period of up to twelve months to enable determination of other claims. Furthermore the Commissioner was empowered to set aside part of the fund for claimants whose entitlement had not been determined and persons likely to make a claim in the future.

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25 Unreported, Credit Tribunal 22/88/05. See also *Daly v. Sydney Stock Exchange Ltd* (1986) 160 CLR 371.

26 Land and Business Agents Act 1973 (S.A.) s.72(3).

V. ACCOUNTS AND AUDITS

Enforcement of the obligation to place funds in trust accounts depended firstly on the limitation of the right to a land broker's licence to persons who were fit and proper and secondly on the processes for the supervision of account keeping.

Whilst licensing was the responsibility of the Registrar-General, control over entry to the occupation was personalised and discretionary. Courses for would-be brokers were run by the Registrar-General and staff of the Lands Titles Office and the success rate was relatively low. The creation of the Land Brokers' Licensing Board led to the establishment of prescribed qualifications. The interest of educators is in justifying the quality of education and ultimately involves pressure for a greater through-put. All this means an opening-up of a relatively closed shop and diversity carries risks - one of which is the potential for dishonesty.

Audits cannot stop defalcations but they can limit their continued operation. Under the 1973 legislation brokers were required to "keep full and accurate accounts of all trust monies received ... and of any payment of or dealing with any such monies" and to "keep those accounts separately and at all times properly written up and in such manner that they can be conveniently and properly audited at any time".[27] By regulations each person who carried on business as a land broker was required within two months of the end of each year to have his or her trust account audited and then forthwith to obtain a report from the auditor and forthwith to deliver that report to the Board. From 1974, where an irregularity was detected with respect to the keeping of trust accounts such as tor require immediate supervision or other listed defaults occurred, the Board was empowered to appoint a supervisor.[28] No payment could be made from the trust account without the supervisor's signature.

The need for the independence of the person appointed as a supervisor has been emphasised by the Commercial Tribunal:

> The Tribunal would be prepared to appoint an agent's or broker's own auditor as the person to exercise the powers under Section 63a only in exceptional circumstances. The auditor of an agent's or broker's trust account has responsibilities to persons other than the agent or broker.
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> Although he is engaged and paid by the agent or broker, it is clear from a perusal of the Land Agents, Brokers and Valuers Regulations that an auditor is also, in a sense, responsible to the Tribunal and to the Commissioner for Consumer Affairs (see for example, regulation 28(g) and 30(e)). He must therefore maintain, independence from the agent or broker. If the same person were to have both the authority to manage the trust account and the responsibility to audit that trust account, he or she would not have that necessary degree of independence. An auditor should not be placed in a situation which could give rise to a conflict of interest or a conflict in his or her responsibilities.

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27 Land and Business Agents Act 1973 (S.A.) s.62(6).

28 Inserted by the Land and Business Agent Act Amendment Act (S.A.) 1974.

> Such a situation would arise if an auditor has to report on transactions that took place while he or she was in charge of the account being audited. It is also conceivable that in managing the trust account an auditor may discover matters that he or she had failed to notice and report on during a previous audit, which would again give rise to a conflict.
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> The Tribunal therefore rejects the application by the respondent and indicates that it would generally not be prepared to agree to an agent's or broker's own auditor or accountant being appointed to exercise the powers conferred by Section 63a.[29]

In the 1986 amendment the duty to keep proper records was restated[30] and the duty to have the accounts audited stated in the Act[31] rather than in regulations. A date for submission of the auditor's report was to be prescribed by regulation.[32] As part of the administrative change the reports were to be submitted to the Commissioner rather than the Land Brokers Licensing Board. The Annual Report of the Commissioner for Consumer Affairs for 1986-87 expressed concern at the number of agents and brokers who failed to lodge audit reports on their trust accounts by 1st March as required by the regulations.[33] Further in the 1986 legislation the Commissioner was empowered to appoint an examiner to review records generally or in any particular case and to review audit procedures.[34] During the 1987-88 operational year staff were appointed for the purpose of examination of records. The Commissioner's 1987-88 report comments:

> As at 30 June, 1988 a Financial Examiner had examined the trust accounts and records of six agents and brokers. In many of the cases, the examiner discovered irregularities in the maintenance of trust accounts and the keeping of records. The agents or brokers were asked to give an explanation of the irregularities would not recur. The effectiveness of this step is that the assurance is given pursuant to Section 79 of the Fair Trading Act 1987 and should the agent or broker subsequently act contrary to the terms of the assurance he or she may be prosecuted by the Commissioner.
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> Some of the irregularities detected by the financial examiner were:
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> (1) Failure to bank monies promptly after receipt;
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> (2) Failure to issue receipts for monies received;
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> (3) Payment of a client's debts before the client has deposited sufficient funds to cover the payments resulting in the client's separate accounts being in credit;
>
> (4) Failure to keep adequate records to enable the receipt and disposition of trust money to be conveniently and properly audited.
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> In the cases where irregularities were detected the audit report was checked to see if the auditor had qualified his or her audit report by reference to the

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29 Commissioner for Consumer Affairs (S.A.), note 14 *supra*, 27.

30 Land and Business Agents Act 1973 (S.A.) s.67(1).

31 Land and Business Agents Act 1973 (S.A.) s.68(1).

32 Land Agents Brokers and Values Act 1973-86 (S.A.) s.68(1)(b).

33 Commissioner for Consumer Affairs (S.A.), note 14 *supra*, 27.

34 Land Agents Brokers and Valuers Act 1973-86 (S.A.) s.69.

> irregularities. In those cases where no qualification was noted, the auditor was asked to explain why no qualification had been made.
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> Some agents and brokers have taken exception to the appointment of a financial examiner to check their trust accounts and records seeing such action as reflecting on their professional integrity.
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> However, in view of recent occurrences with some members of their industry, such as Trevor Schiller and Ross Hodby, the financial examiner's role is extremely important from the point of view of detecting fiduciary default.[35]

In addition a bank or financial institution with which an agent has established a trust account is required by s.71 to report any deficiency in that account. This requirement has been credited with uncovering the most recent case of defalcation:

> ... a bank or financial institution with which a land agent or land broker has established a trust account must report any deficiency in that account to me.
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> Upon receipt of such advice the decision is made whether to simply follow up by seeking an explanation and undertaking to avoid recurrences or whether the problem appears to be serious enough to warrant an examination of the trust accounting records.
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> A notable example of this occurred recently in the case of *Brian Stewart Winzor*, a licensed land broker. Mr Winzor's bank sent two letters to me advising of the overdrawing of the trust account on separate occasions. An Examiner was appointed to examine Mr Winzor's trust account and trust accounting records. The Examiner attended Mr Winzor's business premises and attempted to conduct an examination of his trust accounting records but she found that many of Mr Winzor's documentary records that were required for the examination were not available. Over a period of approximately two weeks Mr Winzor avoided supplying the documentation and avoided appointments made with the Examiner. Eventually the Examiner gathered sufficient evidence to convince me that Mr Winzor had been involved in mortgage financing activities and had committed fiduciary default of trust monies entrusted to him.
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> My officers liaised with the South Australian Police with he result that Mr Winzor has been charged with fraudulent conversion. In addition, Mr Winzor surrendered his licence and was declared bankrupt on his own petition. An administrator of his trust account was also appointed.
>
> At present claims for compensation in respect of losses suffered through his fiduciary default are being received and assessed.[36]

The rules were again changed in 1987 so that the annual audit report had to be lodged with the Registrar of the Commercial Tribunal.[37] The Registrar was empowered to require a broker who had failed to lodge an auditor's report to do so.[38] A broker who failed to comply with a direction from the Registrar within fourteen days suffered suspension of that broker's licence until compliance occurred.[39]

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36 *Id.*, 31.

37 Land Agents Brokers and Valuers Act 1973 (S.A.) s.68(1).

38 Land Agents Brokers and Valuers Act 1973 (S.A.) s.68(4).

39 Land Agents Brokers and Valuers Act 1973 (S.A.) s.68(5).

VI. SCRUTINY OF FINANCIAL PROBITY

The rash of defaults raises questions about the system for ensuring proper practices by land brokers in handling money entrusted to them. On the other hand the willingness to make changes to counter revealed deficiencies cannot be doubted. Some of those deficiencies do seem to have been glaring. In particular the time lag inherent in disciplinary proceedings as a consequence of failure to submit audit reports and the need for spot checks of trust accounts might have been expected to have been recognised before 1987.

The role of the Commercial Tribunal also causes misgivings. In theory the establishment of uniform processes for the granting and review of licences in a range of occupations seems commendable. However specialist knowledge by regulators of the various occupations is removed and streamlining is an excuse for reducing the administrative staff responsible for the process.

The emphasis upon consumer protection authorities also should be brought into question. At the time of writing the future administration of the regulation of building societies and credit unions is under review. For some years this task has been undertaken by State corporate affairs authorities.[40] Expertise in financial scrutiny might well be regarded as the dominant concern in this area. The uncertainties relating to residual aspects of corporate affairs administration make it impossible to suggest any coherent structure for such matters.

One other suggestion has been that all money which is to be invested by a land broker should in fact be deposited with a trustee company. Trustee companies are regulated by separate legislation[41] and subject to stringent accounting regulations. However trustee companies in Victoria and Queensland have themselves experienced financial difficulties. The involvement of such companies must add to the cost and complexity of any transaction. However, as is explained in the next section, at present the real costs of the guarantee fund are not borne by land broker investment transactions and if proper costing did exist the alternative may seem more attractive.

The number of land broker defaults must be a cause of concern. They cannot readily be explained by Australia's economic decline. They coincide with a period of remarkable freedom from lawyer defaults.[42] No obvious characteristic of the individual land brokers involved stands out; in fact the individuals generally seem to have been well established in their occupations and personal lives. As at June 1989 five and one half officers of the Office of Trading were devoted to the enforcement of the Land Agents, Brokers and Valuers Act 1989 and two financial examiners held office. The enforcement duties ranged well beyond responsibility for land brokers' trust accounts and

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40 Pursuant to the Building Societies Act 1975 (S.A.) and Credit Unions Act 1976 (S.A.).

41 Trustee Companies Act 1988 (S.A.).

42 In South Australia at the time of writing no claim had been made on the lawyers' guarantee fund since 1980.

financial reporting. It is not possible from available records to compare enforcement costs with licence revenue. The reports of the Commissioner for Consumer Affairs do not refer to any inability because of staff shortages to carry out enforcement duties properly. It would not, however, be difficult to justify additional enforcement resources funded by licence fees rather than general revenue if any impact could confidently be predicted in terms of land broker defaults. The impact of enforcement is hard to measure. The activities of land brokers have been regulated in South Australia for approximately 130 years. Mortgage finance investment of client's money could be undertaken by persons in unregulated occupations. Default does not seem to have been exposed outside land brokers on a scale similar to that of land brokers. Indeed the Chairman of the Australian Lease and Finance Brokers Association has complained of the harm to his members from lack of precision by members of the community in identifying land brokers as the perpetrators of the frauds. The Chairman asserted that no accredited finance broker in South Australia had even been involved in such a fraud.[43]

VII. PRINCIPLE OF INDEMNITY

The quirk of indemnity for persons who invested with land brokers was exposed by an interjection in the Parliamentary debates:

> **The Hon CJ SUMMER:** There are not time limits, but obviously we would want them paid out as soon as possible. I suppose there is a problem about the future of the fund. At some stage I suspect that this issue will have to be readressed, because essentially what we are providing here is a Government guarantee for people who decide to invest with a land broker. This is basically the situation we have come to.
> **The Hon Diana Laidlaw:** It doesn't happen in too many other fields.
> **The Hon CJ SUMMER:** That is right, but if you do not think it ought to happen you can go to the next meeting of the creditors.
> **The Hon Diana Laidlaw interjecting:**
> **The Hon KT Griffin:** I assume that's off the record.
> **The Hon CJ SUMMER:** No, it was on the record. The Hon Ms Laidlaw said, 'Not many other investors get that sort of protection.'
> **The Hon Diana Laidlaw:** Well, its a fact.
> **The Hon CJ SUMMER:** The honourable member said that it is a fact - she is dead right. The point is that we are doing it here. The point that the honourable member makes leads to the questions: what is this fund all about and what is its future? Obviously, everyone recognises that we have to do this now; do it as equitably as possible; and ensure that these people are paid. If this means that we will go on with it, it is always subject to there being enough money in the fund. If there is enough money in the fund, people who invest in that sort of investment have, in effect, a sort of Government-backed guarantee that they will not lose, but they might not get their full interest as well.
> I think that is the restriction that exists on it, and that might not make it quite as attractive to investors as would appear on the surface, because it is unlikely that they will get full capital return plus the full interest return that they would

43 Letter to the Editor, *The Advertiser*, 25th October 1990, 18.

> otherwise have earned. Nevertheless, it is virtually a capital guarantee if we proceed in the future with what we are doing now. It is possible that at some stage in the future someone will have to readdress what this fund is for and how it will be used - but that is in the future. At the moment we are trying to get the money paid out as quickly as we possibly can to these people who have undoubtedly lost a considerable amount and who generally are in a position where they cannot afford to lose that sort of money. They got sucked in by people who on the face of it were respectable honest brokers. These people unfortunately got sucked in to investing with these brokers; they have lost; and it is the Government's intention to try to redress that problem as quickly as possible.
>
> However, this raises the question of the future of this fund. Is it going to be forever a guarantee to people for capital lost in this sort of investment? It is obviously subject to the size of the fund at any time but, if there are no more claims on the fund for the next five years and it builds up again to $6 million, $7 million or $8 million, we then have a situation of what we will do with it. Will it stay there as a capital and interest guarantee for this sort of investment, or will something else be done?[44]

The fund provides a guarantee for investors. It happened that in 1988 there was $6 million in the fund. The income of the fund from interest on trust accounts was approximately $250,000 per month. Availability of the guarantee thus depended on an absence of similar claims for some years previously. So there is a quirk of time. But as well investors with land brokers had available a fund which was derived from the interests of trust accounts of land agents and land brokers. The requirements as to trust accounts and the indemnity fund is the only part of the legislation common to land agents and land brokers. There is no obvious reason for a single Act. It could well be regarded as a further quirk that agents and brokers are dealt with in the one Act and have a single indemnity fund because the government was seeking when introducing revised regulation of agents to remove the operational link between agents and brokers. Moreover it is much more likely that agents rather than brokers will hold significant funds in their trust accounts for a lengthy period. Brokers mainly receive monies for immediate settlement of transactions; agents often hold deposits during the period between the contract and settlement. The guarantee for investors with brokers is thus heavily subsidised by purchasers of residential and other properties.

The guarantee protects investors. But there is a fairly direct benefit to borrowers. The guarantee encourages the availability of mortgage finance from private sources. Patterns within financial markets constantly change. It has been pointed out earlier that it is only in the past thirty-five years in Australia that private banks have expanded as savings banks and that prior to that time private mortgage funds supplemented the restrictive policies of government savings banks. Today private mortgage funds are often used as a source of bridging finance. The absence of such funds necessarily would weaken the opportunities for home buyers.

Most investments produce benefits; sometimes those benefits are less direct and economists can argue as to the impact of matters such as the takeover

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44 South Australia, *Parliamentary Debates*, 6th October 1988, 902.

frenzy. However not all investments are guaranteed. As mentioned earlier the handling of investment funds is not an activity which is the exclusive province of any occupation or occupations. Consequently whilst there are statutory guarantee funds to cover defaults by lawyers and land brokers there are no such funds for members of other occupations which handle investments for their clients. There are no guarantees with respect to a company whose business is to invest client's money even though trusts are set up in favour of the clients. Again recent times have seen the collapse of one such company whose activities had been heavily promoted through television commercials. In South Australia a guarantee fund is established with respect to credit unions[45] and building societies[46] are supervised and should any irregularity be exposed, management of that society may be taken over. In Victoria one group of building societies ceased to trade and only after protracted protest over government refusal to intervene was some support provided for investors by the Victorian government. Banks which are licensed under the Commonwealth Banking Act are also closely monitored and in the case of irregularity, management may be taken over by the Reserve Bank.[47] In the case of the large domestic banks a government reserve poses monetary problems as financial assistance by government would have to be of such a magnitude that the action will impact on the value of the currency.

The South Australian Attorney-General in the passage quoted above indicated that he was not prepared to face investors with Hodby and Schiller without a promise of substantial government protection. The Victorian government found that resistance by it to intervention to protect building society investors could not be sustained. The plight of investors impacted considerably on their community and in that case the impact had a regional concentration in areas which had traditionally supported the government party. In an earlier article I pointed to the parallel between non-intervention by government and the plight of Indian women portrayed in the movie "A Man Called Horse".[48] In that movie the Indian woman who lost her spouse and could not find a substitute took herself into the hills to die from starvation. In our society we limit indebtedness by the availability of bankruptcy and for the past fifty years have provided a social welfare system. Since the depression government policy can be stated in general terms to be that investors with banks receive a guarantee for their investment. Some other investments are guaranteed; this article has examined the protection for investors investing through land agents. How far investors have appreciated the extent of any government guarantee is

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45 Credit Unions Act 1976 (S.A.) Part VIII.

46 Building Societies Act 1975 (S.A.) s.67.

47 Banking Act 1959 (Cth) ss.14-16. See W.S. Weerasoona, *Banking Law and the Financial System in Australia* (2nd ed., 1988), 43.

48 A.P. Moore, "Measuring the Economic Impact of Consumer Litigation" in R. Cranston and A. Schick (eds) *Law and Economics* (1982), 173.

unknown. Information on the matter in legal texts is very scant. Government has a responsibility to rationalise and explain clearly the extent of guarantees. Guarantee funds should be constructed to relate to exposure to risks and the history of calls upon them and financed so that any activity is self-supporting rather than subsidised by some other activity or by the community generally. It is also likely to be to the advantage of members of an occupation to promote client confidence by the provision of guarantee funds. Not only have defaults by South Australian land brokers been excessive but the burden of these defaults has not been properly brought home to brokers in general.