Avoid a shirtfront

Know when your advice firm is really a front

David Huggins

A recent disturbing trend in financial advice is the creation of what I will call "the front" financial planning firm. These are companies that look like standard financial planning firms when they are really fronts for property development schemes.

Using a seemingly legitimate business as a front for something dodgy is nothing new. Anyone who has seen the Robert De Niro film Casino, which is pictured above and shows the mob at work in Las Vegas, knows how it works.

In the case of the financial planning scam it work like this. A financial planning firm is set up that is designed to lure investors into a property development scheme. Some of these firms have sophisticated websites that give the impression that the firm provides quality financial planning services.What they really do is identify investors for the property development scheme.

When the client meets with the representative of the firm, the representative will go through a charade designed to resemble what ordinarily happens when a client meets a financial planner.

What actually happens is the client is advised to buy a house-and-land package — one that usually is to be built in a semi-rural area of the Eastern States.

Clients need to think carefully about how the value of these packages have been calculated, particularly as they are to be built in places that are thousands of kilometres away, the client has never been to and knows nothing about.

They also need to ask themselves two questions. The first is: what are their other investment options? Why is a financial planner who normally provides advice about financial products such as shares, superannuation or managed investments telling a client to invest in a house-and-land package?

The second is: if these types of investments really were appropriate then surely there must be a similar investment closer to Perth that would be much easier to manage.

The real nature of these types of financial planning firms can be seen when it is understood that they actually consist of a number of parts that each work together to extract fees, commissions and profits from clients at every stage of the investment process.

The first stage involves a mortgage broker. Having been persuaded to buy the house-and-land package, the firm acts as the client's mortgage broker to obtain finance and receives a commission for performing this function.

The second is a law firm. The firms acts as the client's conveyancer to buy the house-and-land package.

The third is a building company. I have seen examples where the financial planning firm has an associated building company that builds the house.

Finally there is a real estate agent. The real estate agent is engaged, for a fee, to find tenants for the house and to manage those tenants. When the investment turns sour, often because tenants are thin on the ground where the house has been built, the client will be advised to use the real estate agent to sell the property. This generates one final commission payment and more conveyancing fees for the law firm.

When their investment performs poorly, as it almost always does, the clients finds out one further disturbing thing about their financial planner — the firm has got around the regulatory system that applies to the provision of financial advice.

Clients have extensive rights when they have received poor financial advice from a financial planner. Financial advice is advice that is provided about financial products such as shares and does not include advice provided about an investment in property.

Firms that receive client complaints argue that no financial advice has been provided because the advice was about a potential property investment and that therefore they are not liable to pay compensation. These arguments will not always succeed and even if they do there are ways to make claims against firms that operate this way.

David Huggins is a lawyer who specialises in resolving disputes about poor financial advice