

Governance of Consumer Interests Concept Paper

Introduction

- 1) “Consumer interests” are matters relating to business transactions undertaken by consumers that would typically include elements of both consumption and investment. They include club memberships, time-shares, retirement villages, and farms. The present review is motivated by:
 - a) the *developmental* opportunity to establish a sound and attractive regulatory framework that will help to strengthen and enhance Singapore’s reputation as a safe and well regulated place for consumers to undertake business transactions; and
 - b) a history of *persistent problems* that have arisen in the sale and governance of consumer interests.
- 2) In our quest to become a world class city, we must provide a robust framework that seeks to regulate and govern the transactions that take place between businesses and the consumer. This framework must be comprehensive and broad enough to include offers ranging from the sale of ostrich eggs to governance of club memberships and time shares.
- 3) A conducive regulatory framework will boost economic development in two ways. First, this will be the necessary foundation for more business to consumer transactions across the economy since there is more confidence in the integrity of our system. Secondly, we might even develop into a hub for the management and trading of such “consumer interests” located in other countries in the region.
- 4) Following are some examples of problems that have arisen in the *sale and governance* of consumer interests:
 - a) Clubs: Pinetree Town and Country Club, Fort Canning Country Club and Ponggol Marina collapsed and memberships became worthless. In particular, the owner of the Pinetree Club used funds paid by club members to invest in China highways. When his investment failed, the club was sold and club memberships became worthless. The promoters of Raffles Town Club were found in breach of contract, for having sold an excessive number of memberships. The Sir Stamford Club and Green Club collected application moneys and collapsed without ever opening.
 - b) Time-shares: Between March 1, 2004 and February 28, 2005, in the first year of operation of the Consumer Protection (Fair Trading) Act, the largest number of cases filed with the Consumer Association of Singapore (“CASE”) concerned time-shares (158 of 443 cases). Several timeshare operators have been unable to maintain their facilities. Members have used legal action to recover membership fees, but this remedy is ineffective against insolvent operators. Another problem is timeshare

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operators that sell so many memberships that members have difficulty booking vacations. Further, some timeshare contracts do not include provisions for termination, thus compelling members to be locked in.

- c) Foreign real estate: Presently, in comparison to the regulatory standards for the sale of securities, there is very little regulation of the sale of foreign real estate. A foreign developer may sell foreign properties in Singapore based on mock up models and life style promises. In recent years, Singaporeans have bought properties in China, Australia, Malaysia, and elsewhere. However, many subsequently learned that the properties were poorly developed or located, or worse still, did not get delivery as the developer failed or absconded. Buyers are often left with little recourse in such situations.

Current Regulatory Framework – Singapore

- 5) The most basic consumer protection arises from the common law applicable to all transactions. These include criminal penalties if cheating is proved and civil liability for breach of contract and misrepresentation.
- 6) In addition, the Consumer Protection (Fair Trading) Act (“CPFTA”) prohibits unfair practices, such as making false claims or misleading consumers through the omission of information. The CPFTA provides for compensation of up to \$20,000. However, the CPFTA:
- a) addresses only *disclosure*, rather than *governance*;
 - b) does not impose *affirmative* disclosure rules; and
 - c) covers only transactions in Singapore
- 7) The sale of real property (including that outside Singapore), banking services, and securities and futures are specifically excluded from the CPFTA. It is instructive to consider Singapore’s approach with respect to corporate governance. The Government established the Council on Corporate Disclosure and Governance, which has issued a Code of Corporate Governance. Exchange-listed companies are not legally bound to comply with the Code. However, they are required to disclose their corporate governance practices and explain any deviations from the Code in their annual reports. In practice, most companies would comply with the Code under the pressure of possible censure from the media and the public.
- 8) The sale of residential real estate *within Singapore* is governed by the Housing Developers (Control and Licensing) Act (Chapter 130), Housing Developers Rules. Under the Rules, the developer is required to disclose specific information, including the tenure of the property, in any advertisement and payments made by purchase are held by the Singapore Academy of Law. Governance of strata title real estate is regulated by the Land Titles (Strata) Act (Chapter 158).

Current Regulatory Framework – International

- 9) Australia. Timeshare schemes are interests in a managed investment scheme (“MIS”) and so are considered to be financial products. They must comply with Corporations Act 2001, Chapters 5C and 5D, and the responsible entity must be licensed under the Act.¹ Chapter 5C imposes duties of governance, and in particular, the responsible entity must hold the scheme property on trust for members. If fewer than half of the directors of the responsible entity are external directors, the law requires an independent compliance committee. Under Chapter 6D, any offering of an MIS must be accompanied with a prospectus.
- 10) European Union. Council Directive 94/47/EC of 26 October 1994² requires written disclosure and written contract in the sale of timeshares. Items required to be disclosed include guarantee regarding completion of the facilities or reimbursement of payment if the facilities are not completed, purchase price, charges for re-sale, and cancellation procedures.³ The Directive has since been implemented by the various European Union member states, e.g., by the United Kingdom through the Timeshare Act 1992, as amended by the Timeshare Regulations 1997.⁴
- 11) Malaysia. Under the Companies Act, memberships in golf, recreational, marina clubs, and memorial parks and timeshares are “interests”. Promoters must seek approval by the Companies Commission of Malaysia, publish a prospectus including information relating to facilities, stage of development, and maximum number of members, and appoint a trust company to hold members monies in trust. The facility must be at least 50% completed before memberships may be offered for sale.⁵
- 12) United States – Clubs. Sale of club memberships within the United States is governed by both federal and state law. Depending on the circumstances, a club membership may be considered a security, and so, subject to disclosure requirements.
- a) Under federal law, a security is defined by the four-prong *Howey* test: where a person:
- i) invests his money;
 - ii) in a common enterprise; and
 - iii) is led to expect profit; and

¹ Hans Tjio, Principles and Practice of Securities Regulation in Singapore, Singapore: LexisNexis, 2004, Section 3.16.

² Official Journal L 280, 29 October 1994, 0083-0087.

³ Directive 94/47/EC of 26 October 1994, Annex, paragraphs (d)(5), (i)-(j), (k), and (l).

⁴ European Commission, Consumer Affairs, Report on the Application of Directive 94/47/EC of the European Parliament and Council of 26 October 1994.

⁵ Companies Commission of Malaysia, http://www.sssm.gov.my/guidelines_interest.htm/, viewed, June 24, 2005.

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- iv) solely from the efforts of a promoter or third party.^{6 7}
 - b) The courts of California and many other states apply a four-prong “risk-capital” test,^{8 9} viz.,
 - i) the offeree provides initial value to the enterprise;
 - ii) the initial value is subject to the risks of the enterprise;
 - iii) the initial value is induced by representations leading to a reasonable understanding that the offeree will realize a valuable benefit beyond the initial value (which benefit need not be a monetary profit); and
 - iv) the offeree does not exercise practical and managerial control over the enterprise.
 - c) Based on “no-action letters” issued by the Securities and Exchange Commission (“SEC”),¹⁰ a club membership which is freely transferable and for which the profit from re-sale is not limited *is* deemed to be a security. A club where members’ subscriptions are used to finance construction *may* be a security.
- 13) United States – Time-shares. Sale of time-shares within the United States is governed by both federal and state law. Depending on the circumstances, a time-share may be considered a security, and thereby be subject to disclosure requirements. A time-share is more likely to be considered a security if it is offered as an investment rather than a place to stay.¹¹

Way Forward

- 14) Based on the preceding review, we conclude that
- a) The regulatory framework for sale and governance of consumer interests in Singapore has fallen short of that in other regional and international jurisdictions;
 - b) What is needed is a framework of disclosure that
 - Enables Singapore consumers to make an informed choice, and
 - Is sufficiently robust to accommodate future developments in product development, marketing, and technology, e.g., to encompass solicitations through the Internet.
- 15) Generally, we see three possible ways to establish the framework:
- Extend existing laws;
 - Caveat emptor;

⁶ SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

⁷ Thomas Lee Hazen, *The Law of Securities Regulation*, 4th Ed, St Paul, MN: West, Section 1.6[2].

⁸ Hazen, *supra*, Sections 1.6[3].

⁹ Silver Hills Country Club v. Sobieski, 55 Cal 2d 811 (1961).

¹⁰ Robert J. Haft and Arthur F. Haft, *Analysis of Key SEC No-Action Letters*, 2004-2005 Edition, Eagan, MN: West, 2004, sections 1.15-1.17.

¹¹ Hazen, *supra*, Section 1.6[9].

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- Separate legislation.
- 16) Caveat Emptor. In principle, the relevant industry could develop a “Code of Conduct”. Adherence would be voluntary, but non-compliance should be disclosed. This would improve standards without undue increases in costs. In the case of corporate governance, self-regulation works because the Singapore Exchange requires listed companies to either comply or explain why they do not comply.¹² In the case of consumer interests, however, there is usually insufficient liquidity for a “comply or perform” approach. Further, the degree of competition may be so limited that no seller benefits by offering higher standards. For instance, proprietary clubs are sold relatively infrequently: in a thin field, it is hard for the “good guy” to stand out.
- 17) Extending Existing Laws. Having reviewed various laws – the CPFTA, Securities and Futures Act, Financial Advisers Act, we have concluded that the best approach is to amend the CPFTA. The amendment would expand the scope of the CPFTA to regulate *governance* as well as the *sale* of consumer interests.
- 18) Following a detailed study, we have developed a draft bill, which is attached.

Members of Working Group

Seah Seng Choon
Sin Boon Ann, MP
Hans Tjio
Yeo Guat Kwang, MP
Ivan Png, NMP

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¹² This approach works in the capital markets because non-compliance can be traded off for strong share price performance (MacNeil and Xiao Li, “Comply or Explain”: Market Discipline and Non-Compliance with the Combined Code” http://papers.ssrn.com/sol3/papers.cfm?abstract_id=726664).