The Institute of
Chartered Accountants
in Australia

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26 June 2009

Committee Secretary,
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100 Parliament House
Canberra ACT 2600

Email: corporations.joint@aph.gov.au

Dear Madam/Sir,

Inquiry into Agribusiness Managed Investment Schemes

The Institute of Chartered Accountants in Australia ('the Institute') welcomes the opportunity to make a submission to the Inquiry into Agribusiness Managed Investment Schemes.

The Institute of Chartered Accountants in Australia (the Institute) is the professional body representing Chartered Accountants in Australia. Our reach extends to more than 62,000 of today's and tomorrow's business leaders, representing over 50,000 Chartered Accountants and 12,000 of Australia's best accounting graduates who are currently enrolled in our world class Chartered Accountants postgraduate program.

Our members work in diverse roles across commerce and industry, academia, government, and public practice throughout Australia and in 140 countries around the world.

We aim to lead the profession by delivering visionary leadership projects, setting the benchmark for the highest ethical, professional and educational standards, and enhancing and promoting the Chartered Accountant brand. We also represent the interests of members to government, industry, academia and the general public by actively engaging our membership and local and international bodies on public policy, government legislation and regulatory issues.

The Institute can leverage advantages for its members as a founding member of the Global Accounting Alliance (GAA), an international accounting coalition formed by the world's premier accounting bodies. With a membership of approximately 775,000, the GAA promotes quality professional services, shares information, and collaborates on international accounting issues.

Established in 1928, the Institute is constituted by Royal Charter. For further information about the Institute, visit **charteredaccountants.com.au**
The Institute has addressed a selection of the issues raised in the terms of reference that it believes it is most appropriate to provide comment on.

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The Institute views the Parliamentary Joint Committee's Terms of Reference into 3 categories:

1) The impact and consequences of managed investment schemes on rural and regional Australia
2) The overall structure and operations of the industry including business models, taxation implications
3) The distribution of the managed investment scheme products and the regulatory environment of management investment schemes

It should be stated that agribusiness managed investment schemes were developed, promoted and distributed within the current regulatory and legislative framework and that despite this the financial services industry is faced with the collapse of two large agribusiness companies and what appears to be the loss by a large number of investors' funds. While there are specific tax effective aspects to agribusiness managed investment schemes these were under the auspices of the tax system and the various schemes had received the appropriate tax rulings.

It should also be noted that the concept of managed investment schemes has wider implications than those relating to the agribusiness industry.

Impact of managed investment schemes on rural and regional Australia

The agribusiness managed investment scheme industry has a specific public policy responsibility. Whilst the Institute acknowledges the potential benefits the industry can bring to the development of regional Australia, its rapid growth has resulted in a range of distortions to the agricultural market. It is these distortions that need to be addressed as opposed to the removal or significant restructuring of the managed investment scheme framework in order to ensure that the envisaged public policy outcomes of developing regional Australia are met

In many areas of Australia managed investment schemes have resulted in the increase in land prices to the detriment of local farmers who are unable to justify prices offered for land by MIS promoters. The agribusiness managed investment schemes introduce a class of investors who have access to tax-deductible capital sources while traditional rural producers competing against them for productive rural land do not. As a result the market is distorted by a group of participants whose investment drivers are not risk based returns relevant to the particular asset class of the investment but the prospect of substantially deferring taxable income. Consequently some changes may be required to the current tax arrangements for managed investment schemes to address this.

Anecdotally traditional operators and farmers are unable to compete with the large inflows of capital by the managed investment schemes.

Conceptually the Institute supports managed investment schemes as they are an option to bring capital to rural Australia which would not otherwise occur. In addition there are various other benefits such as increased employment opportunities.

Due to what appear to be considerable distortions by these agribusiness managed investment schemes it could be argued that managed investment schemes should only be allowed where there is a national interest element, such as becoming self-sufficient in wood pulp production, or preventing the destruction of rainforest in other countries.

It would appear that the issues that have arisen from the agricultural managed investment schemes have skewed parts of the industry and that the agribusiness industry grew to become larger than the intended objectives of the original model and structure.

The distribution of managed investment scheme products and the regulatory environment of management investment schemes

The Institute believes that the remuneration models that exist within the agribusiness industry contributed significantly to the distortions that developed within rural and regional Australia. The remuneration models (and the tied representatives) contributed to the enormous flows of capital available to the agribusiness firms.

By addressing the issue of remuneration and the distribution of these schemes may well reduce the large inflows of capital that skewed parts of the industry.

The Institute has led the debate associated with commission structures and the financial services industry. While the industry in general can address a wide range of issues and factors to improve the advisory service provided to investors in Australia – remuneration is a critical aspect.

Inherently the remuneration models that are based on the sale of products will inevitably result in real and perceived conflicts of interest. In addition where there are significant tax incentives combined with high commission rates this can potentially encourage inappropriate advice or a bias.

The agribusiness industry has traditionally been based on high commission structures (upfront up to 10%) to The Institute has traditionally has had strong view in regards to remuneration models associated with financial products.

A question must raised regarding the licensing regime where a company can apply for an Australian Financial Services License that is limited to advising only on their own products that are limited to a range of agribusiness managed investment schemes and then authorise individuals to advise only on these limited range of products.

While there is industry discussion around institutions having a tied sales forces the issue is not specifically that authorised representatives are tied to a product manufacturer (eg fund manager/ institution) and are limited to advising only on their products and services. In many cases these “tied” authorised representatives are able to provide advice on a wide range of products, services, investment structures, (eg superannuation, non superannuation, insurance, fixed interest products etc) It is the fact that representatives maybe limited to one type of product by that AFSL holder, in this case advising only on agribusiness managed investment schemes of that product manufacturer.

License condition example:
“This licence authorises the licensee to carry on a financial services business to:
Provide general financial product advice for the following classes of financial products:

a) (i) interests in managed investment schemes limited to:
    a. (A) own managed investment scheme only; and

This would appear to be an anomaly in the licensing regime as to how an authorised representative can appropriately provide advice when the products/ services are significantly limited.

The Institute believes this is an area that should be specifically addressed. It may well be part of the overall Parliamentary Joint Committee inquiry into financial products and services in Australia.

The overall structure and operations of the industry including business models , taxation implications

The taxation arrangements applying to agribusiness managed investment schemes has for a number of years been considered by many to be overly concessionary. The ability for significant up-front tax deductions to be offset by taxpayers against certain other taxable income appears to create a “distortionary effect”; whereby some MIS investors enter into these arrangements with a sole or primary purpose of accessing the significant up-front tax deductions in order to reduce current year taxable income from other sources.

It could be said that a distortionary effect such as this is sufficient to influence some MIS investors' behaviour with the result being that rational investment criteria are given less consideration than the short-term tax attributes. It is generally accepted that sound economic and taxation policy dictates that tax attributes should never serve as a sole or primary driver of investment decision-making.

Whilst some elements of the agribusiness MIS sector have proven to be a valuable source of industry and community development in Australia, it is our view that steps could be taken to reduce the incidence of the distortionary effect we describe above. For example, in order to eliminate a major component of the existing distortion, it may be appropriate to consider a 'loss quarantining' mechanism for MISs carried on through corporate structures, whereby the significant up-front deductions attributable to a particular agribusiness MIS could only be carried-forward and offset against future taxable income from the same agribusiness MIS. Precedent for this approach can be found in the current taxation law in the rules which quarantine the use of capital losses from being able to be offset against other revenue account-based income.

An alternative approach, which also has precedent in taxation law, may be to introduce a mechanism whereby the early year tax deductions available under an agribusiness MIS are limited or capped (in quantum or proportionately), such that capital costs relating to land acquisition cannot be converted from being a non-deductible capital item to a tax deductible cost. This approach may involve additional complexity for regulators, MISs and taxpayers when compared to the quarantining approach suggested above.

Other comments

Consumer education and understanding

It is widely recognised that consumer education is an important component to the overall strengthening of the financial services industry as whole. It must be beneficial to have investors who have a greater knowledge and understanding of their financial position and the financial alternatives that exist.

The financial services industry continues to promote the need for consumer education and the need for consumers to take a greater responsibility in regards to their finances and the decisions they make in regards to the their financial future. Similarly the regulators have focussed on building consumer knowledge through various financial literacy programs.

However while beneficial, consumer education is not a short term solution that will resolve the problems experienced by the agribusiness MIS collapses. The benefits of consumer education is a generational factor for the financial services industry, when the various education programs filter through the school and education networks and the financial understanding by investors becomes the norm rather than the exception.

In reference to agribusiness managed investment schemes these that have the added layer of complexity with the associated taxation implications. These schemes have a different knowledge requirement as opposed to building consumer understanding and education around the need for budgeting, long term saving, superannuation, insurance requirements and the general financial services products and services.

In summary, consumer education is important but limited. Similarly consumers' taking a greater responsibility for their investment decisions is beneficial but in the short term it is again limited. While consumer's may realise they are required to take on a level of personal responsibility they will in the majority of situations continue to want to find an adviser who can assist them and who they can trust.

Promotion of managed investment scheme

The financial services industry has developed significantly over the last 20 years. This development has resulted in an increase in the complexity of product structures, increased regulation and with this the provision of highly detailed product disclosure statements (PDS). The increase in size and details within the PDS while providing additional information and meeting the regulatory requirements, has not made it easier for consumers to understand.

The Institute supports the Government's current initiative to review PDS structures and formats to make them simpler and user friendly. In stating this it should be noted that agribusiness managed investment scheme products are more complex and higher risk products than many others and this should be considered in any review of PDS structuring.

Adviser Education

In consideration of the complexity of these schemes for example the long term nature of the investments, the taxation implications, and associated risk factors of the agricultural industry specific expertise is required.

The Institute would recommend a review of the requirements for who can advise on these schemes.

Legislative or regulatory change

As a result of the recent collapses it will be considered that making additional legislative and regulatory change is appropriate. However it should be noted that these schemes operated within a strong regulatory environment, supported by ATO product rulings - would further regulation have prevented the collapses in the industry. The Institute would purport that additional and more complex regulation is not the answer, rather it is a review of the specific attributes of the agribusiness managed investment scheme structure that should be reviewed.

Conclusions

While there a number of issues associated with the agribusiness managed investments scheme framework some of which are peripheral the key aspects revolve around the distortions as a consequence of 3 areas - .the inherent taxation arrangements, the remuneration model structures and the licensing regime. Combined these 3 aspects have resulted in a framework which has not delivered an appropriate framework for the industry, investors or the development in regional Australia.

Should there be any queries on this submission, please contact in the first instance Mr Hugh Elvy, the Institute's Head of Financial Planning and Superannuation on 02 9290 5564or at hugh.elvy@charteredaccountants.com.au

Yours sincerely,

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The Institute of Chartered Accountants in Australia