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Mr Bernie Ripoll, MP  
Chairman  
Parliamentary Joint Committee on Corporations and Financial Services  
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Dear Mr Ripoll

### **Inquiry into Agribusiness Managed Investment Schemes (MIS)**

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The Financial Planning Association of Australia (FPA)<sup>1</sup> welcomes the opportunity to respond to the Committee's inquiry into agribusiness managed investment schemes (MIS).

We note the terms of reference largely address issues pertaining to the products themselves. We consider this approach to be appropriate, as much of the concerns arise as a result of the specific nature of the product and associated corporate models. The impact of the recent collapses in agribusiness MIS should be seen in the context of a specific product model failure and how consumers might be misled by distribution models that meet the regulatory standards of other participants but in fact are dedicated sales channels for a single product. The use of this particular type of authorised representative model in Corporations Law is cause for concern and further investigation.

In this submission we focus on the role of financial planning advice, particularly that provided by professional financial planners, who, in our environment, cover a full suite of client needs and by definition cannot be restricted to single product distribution. While financial planners deal with the full range of products and strategies in the financial marketplace, including agribusiness MIS, they cannot be held responsible for companies going into receivership as they have no control over the corporations behind products or market eventualities, however they can control whether their advice has a reasonable basis and is appropriate for the client.

We identify below the use of agribusiness MIS in clients' portfolios and the regulatory oversight and licensee obligations that underpinned recommendations of these products. We highlight key concerns with the distribution of the product and note how the Financial Planning Association's professional obligations address concerns that have been highlighted with regard to advice on these products.

In our view, concerns around the failure of these schemes can broadly be categorised into the following key elements:

- Risk management;
- The regulatory environment – incentive and disincentive;
- Issuer model of products; and
- Influence and incentive structures.

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<sup>1</sup> The FPA is the peak professional organisation for the financial planning sector in Australia. With approximately 12,000 members organised through a network of 31 Chapters across Australia, the FPA represents qualified financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than \$630 billion.

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## **1. Risk management - agribusiness MIS as an asset class**

### **1.1 Portfolio use of Agribusiness MIS**

Financial planners help their clients meet their personal financial objectives, through effective budgeting, saving advice and planning of investment. Agribusiness MIS can and have played a legitimate role in client portfolios, particularly those clients in need of diversification of returns from traditional asset classes.

Agribusiness MIS have operated for a substantial period of time in Australia and are well developed in other jurisdictions, notably the United States. The products themselves were often highly rated and, as noted below, subject to extensive oversight. The products invested in tangible assets that were particularly attractive give the current debate on green issues.

It should be noted that the products are themselves a result of positive government policy to encourage investment in these assets. Also, several other agribusiness MIS are still in existence and still functional, potentially due to a different management approach or other factor(s).

One of the attractions of these schemes, as we discuss later, was the tax effectiveness of investing in them. Investments that are promoted for tax deductibility should raise concerns about longer term risk, suitability for clients, and sustainability. Further, investments in agriculture that are subject to drought, climate change and so forth increase the risky nature of them and these factors also must be considered.

Each of these is an issue of risk management and should be well understood before products are considered and then identified in the product construction, in the product research and in the advice provided.

## **2. The regulatory environment for agribusiness MIS**

### **2.1 Regulatory confidence**

Agribusiness MIS are subject to a significant level of scrutiny to become investment structures available to Australian investors. As corporate entities they are listed on the Australian Stock Exchange (ASX), and they are subject auditing requirements as other corporate entities. As Managed investment schemes they are also subject to regulatory oversight by ASIC and the ATO. Indeed, it is well documented that the product rulings of the ATO were a key factor in encouraging the view that these products were subject to a level of scrutiny over and above other types of products. A further level of review was that the products themselves were subject to consideration by specialised research houses to present to investors a considered opinion as to their merit as potential investments.

A question remains for the Inquiry as to whether the regulatory environment deliberately encouraged investment through these vehicles by awarding special taxation consideration and allowing them to be positioned as ASX listed (in some cases), ASIC regulated, ATO approved investment schemes.

Given these overlaying regulatory structures it is unsurprising that these assets were considered to be appropriate vehicles for investors' funds.

### **2.2 Licensees systems for determining appropriate investments**

As noted above, much of the investment in agribusiness schemes was, and remains, motivated at least in part by the schemes' preferential treatment under Australia's tax regime. Many investors made their decisions to invest based on tax considerations, with potential returns a secondary concern. This contrasts with the financial planning process whereby the focus is primarily on the investment. It is our understanding that where these products were recommended by an Australian Financial Services Licencee (AFSL) or representative that was not directly licensed to the product provider, the size of holdings was relatively small and part of a broader diversified portfolio.

FPA survey data suggests approximately 44% of FPA Principal (ie licensee) members provided some level of advice on agribusiness MIS, and there was a greater proportion of larger licensees recommending agribusiness MIS to their clients. Although business models vary, licensees will typically ensure they have in place effective systems for determining appropriate investments that can be recommended to clients. There is a large universe of investment products available in the market and licensee will reduce this to a more manageable amount through, for example, the use of an Approved Product List (APL). Products on the APL should be subject to a level of scrutiny to ensure they meet licensee requirements and their inclusion should be based on robust research and compliance processes.

A further control is the use of compliance requirements around the level of diversification of client portfolios. FPA survey data suggests that where respondents indicated that they applied a proportion limit, most stated that no higher than 10% of the client portfolio is invested in agribusiness MIS. Others set limits at 5% or even 2% of total portfolio size.

### **3. Issuer model of products - concerns with the licensing and promotion of agribusiness MIS**

#### **3.1 Licensing arrangements**

The agribusiness MIS were distributed primarily through AFSLs and their authorised representatives. However, a key difference between agribusiness MIS and other financial products is the existence of dedicated sales networks to support sales of investments in Great Southern and Timbercorp through which a significant proportion of sales were achieved. In these arrangements, the product provider or an associated company also held an AFSL which authorised representatives to solely sell a particular agribusiness MIS.

As a profession, we are not only concerned with “legally compliant” advice but with “quality advice” that significantly enhances client outcomes. We must question the quality of advice when a representative is limited to recommending only one product.

This raises a significant concern for the financial planning profession that prides itself on clients receiving rounded advice before then giving consideration to a range of products that suit the client, especially because neither the regulatory regime nor the consumer can discern the difference between these two models. It raises questions as to the consumer protection value of current licensing arrangements that allows promotion of these products through such an arrangement and we question whether this can realistically be considered with equal weight under the law as an “advised” model.

A regulatory model that allows licensing arrangements for the use of authorised representatives by product AFSLs should be further investigated as to their appropriateness. Even if such licensing arrangements are considered appropriate, there remains a need for effective ongoing monitoring by ASIC to ensure that such models are able to maintain effective consumer protections in changing market conditions.

#### **3.2 Consumer understanding of advice models**

A key issue that arises is that there is little to differentiate a representative of a licensee that has solely one product to promote. Prospective clients considering such investments should be able to easily identify when they are dealing with a professional financial planner as where a product is provided directly from the provider. We suggest that consideration be given to the defining the term ‘financial planner’ to enable such a differentiation to be made. We would be pleased to engage in a discussion as to how best this might be achieved. Other stakeholders may wish to consider names and roles for those entities that are authorised to advise on and offer only one financial product.

## 4. Influence and incentives for the promotion of Agribusiness MIS

### 4.1 Alternative remuneration

The fall out from the collapses of Timbercorp and Great Southern has identified several potential sources of influence that could impact on the recommendations to invest in these products. There existed arrangements whereby alternative forms of remuneration were provided and a large sales force of Business Development Managers was employed by the providers to promote these 'incentives'.

The FPA provides a robust regulatory framework for its members' professional conduct. Indeed, members are subject to the FPA's *Code of Ethics, Rules of Professional Conduct, Practice Standards*, and a range of other regulations soon to be consolidated as the *Code of Professional Practice*. These extensive obligations are designed to maintain high standards of technical competence, fair dealing, and integrity. They are enforceable amongst the FPA Membership, and may also be used as evidence in litigation. The FPA takes seriously their breach and punishes through fines, suspension or expulsion.

Among other important provisions, the Code addresses objective financial planning, specifically stating that "[o]bjectivity requires intellectual honesty and impartiality. Regardless of the services delivered or the capacity in which a financial planner functions, objectivity requires financial planners to ensure the integrity of their work, manage conflicts and exercise sound professional judgment."<sup>2</sup> Even more specifically, the Rules provide for clear disclosure of

- "remuneration, fees, commissions or any other pecuniary or non-pecuniary benefit whether direct or indirect, received or receivable by the member, the member's Principal, or an associate in connection with the financial planning service;
- any other benefit reasonably capable of influencing the making of the recommendation;
- any benefit that a third party may receive in connection with the recommendation..."<sup>3</sup>

Thus, FPA members are obligated to disclose influences that could affect their advice, to their clients. This would certainly include all forms of remuneration, as well as non monetary forms of compensation, such as educational fact finding trips. In this way, clients can make educated decisions about their financial planners and the plans they propose.

### 4.2 Commission payments

Much has been reported about the commissions paid by Timbercorp, Great Southern, and other agribusiness MIS which brings into question the ability to provide unbiased advice on these products. There is a strong community perception that commission arrangements lead to conflicted advice. Given the range of practices and business model in the industry it is difficult to determine what may be considered an excessive level of commission but the FPA has been determined to ensure remuneration practices do not bias the advice that clients receive and has articulated a set of fundamental principles that should be considered to ensure remuneration is appropriate.

The six key principles of the FPA's new remuneration policy are:

- Consumers must be able to understand the fees they are paying.
- Consumers must be able to compare the fees they are paying.
- Consumers must be presented with a fee structure that is true to label.
- Consumers must be presented with fees that are separated between advice and product.

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<sup>2</sup> FPA Code of Ethics, Section 2, effective July 1, 2009.

<sup>3</sup> FPA Rules of Conduct, Section 106(a)-(c).

- Consumers must agree the fee with their financial planner and should be able to request that the fee is switched off if no on-going advice is being provided.
- Consumers should pay for financial planning services, not product providers.

The policy provides for a client-driven remuneration model to be phased in, effectively eliminating commissions by a specified date, currently 1 July 2012. The policy is now undergoing a period of consultation among the FPA's membership. It is expected to be adopted later this year and become binding on the FPA's membership.

## **5. Role of the Responsible Entity**

As a final point, very real concerns have emerged about the lack of separation between the Responsible Entity (RE) and the products themselves.

Our view is that these schemes are complex management arrangements that require dedicated expertise in determining the value and operational integrity of the schemes as an RE and that this role should arguably not be allowed to combine with that of product owner. In this regard, we encourage the Committee to give due consideration to the structure of Great Southern and Timbercorp products, with reference to their REs. It is important to consider whether a different structure might have led to a different outcome.

Also, we have been advised that it was difficult to obtain accurate information about the true nature of the schemes' underlying cash positions, despite regular contact with senior representatives of the MIS Scheme and annual client seminars. In addition, notwithstanding established compliance requirements being mandated by the Australian Securities and Investment Commission (ASIC) it appears unclear whether scheme compliance was effectively implemented. It would appear that there is need to ensure that accurate data is easily available. Accordingly, investors would welcome a system where there is greater transparency of individual scheme finances on a year by year (even quarter by quarter) basis. Financial summaries could, for example, be posted on the relevant RE's website.

The potential for conflicts and confusion of obligation become exaggerated at the point of a company collapse, when the requirement to hold the interests of all creditors paramount combines with the role of RE, responsible for the integrity of the scheme and investor returns. The recent example of Timbercorp has been an object lesson in the potential for conflict to emerge in this function, when the administrator/receiver ends up functioning and being challenged as a conflicted responsible entity.

In our mind the interests of grower/investors have primacy in this consideration, and certainly whilst ever there are options available to be considered before liquidation.

The FPA is committed to an ongoing dialogue with Government stakeholders on these and other issues. If you would like further information on the issues raised in this submission, please contact Gerard Fitzpatrick, General Manager, Policy and Government Relations (02 9220 4505; gerard.fitzpatrick@fpa.asn.au).

Yours faithfully,



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