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24 June 2009

The Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
Canberra ACT 2600
(by email to corporations.joint@aph.gov.au )

Dear Sir,

**Re: Inquiry into Agribusiness Managed Investment Schemes**

Please find attached my company's submission which addresses the issues contained in your letter dated 3 June 2009.

Maccacorp Ltd (Maccacorp) is a responsible entity and operates a Managed Investment Scheme (MIS) in the macadamia industry. The company was established by macadamia growers in an attempt to expand the macadamia industry. Australia is the leading producer of macadamia nuts and exports approximately 90% of the Australian crop to countries such as USA, Japan, Germany, China and United Arab Emirates. Whilst the macadamia industry only accounts for approximately 1% of the world tree nut market, the Australian industry generates over $200 million in export revenue for Australia.

The successful MIS are operated by agricultural companies using MIS as a means of increasing investment in rural Australia. It is our position that the MIS platform expands the base for those wishing to invest in Australian agriculture and, in my company's case, the macadamia industry. Our scheme assists Australia to improve its balance of payments and provides employment in rural Australia.

The failure of Timbercorp and Great Southern, whilst regrettable, are not inconsistent with corporate insolvencies that occurred in previous economic downturns. Companies such as Ansett Ltd and FAI Insurance failed like Timbercorp and Great Southern due to structural issues and an inability to respond to the downturn.

Should you require any additional information, please do not hesitate to contact me

Yours faithfully,

Donald K Ross
Managing Director

# Submission by Maccacorp Ltd

To the

# Inquiry into Agribusiness Managed Investment Schemes

# By the Parliamentary Joint Committee on Corporations and Financial Services

24 June 2009

## 1 BUSINESS MODEL AND SCHEME STRUCTURES OF MANAGED INVESTMENT SCHEMES

Agriculture is becoming an asset class in its own right and MIS is only part of the spectrum of the types of investment found in agriculture.

Managed Investment Schemes (MIS) allow for investors to contribute funding to a scheme by engaging a manager to establish and maintain a commercial agricultural operation. This type of arrangement is similar to property trusts and equity trusts. In the case of MIS the manager of the schemes is legally accountability and is constantly audited by external reviewers and auditors

In an MIS scheme the rights of the investor are clearly defined in law as are the duties and responsibilities of the management company and the Responsible Entity. The investors receive reports which measure progress against an agreed set of performance guidelines. The whole process is independently audited, by external experts, as to the agricultural progress of the scheme and legally and financially by compliance committees and external auditors.

Alternatively, people may invest in agriculture by acting as an absentee landlord. Absentee landlords tend to employee a manager or management company, usually on a common law contract with varying safeguards and agreed targets or budgetary arrangements, to develop the operation. This more traditional method of investing has funded growth but has not encouraged economies of scale, development of corporate farming models, more efficient water use and the development of export orientated industries.

It is Maccacorp's view that a properly structured and operated MIS is an effective method of developing Australian agriculture and providing financial returns for investors.

## 2 THE IMPACT OF PAST AND PRESENT TAXATION TREATMENTS AND RULINGS RELATING TO MIS

Maccacorp believes that the tax advantage and risks that MIS participants have is consistent with traditional farmers and that tax law applies in the same way to traditional farmers.

All agricultural operations are subject to the provisions of the *Income Tax Assessment Act 1997*(Cth) ("the Act") and *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ("the GST Act"). In addition the tax treatment of non forestry MIS is set out in Taxation Ruling TR 2000/8.

The Australian Taxation Office (ATO) implemented a process of issuing Product Rulings which provides certainty for the tax treatment of any individual scheme. This process is similar to the issuing of Private Rulings by the ATO. The maximum benefit received by a participant in an MIS is only comparable to the tax benefit equivalent to the inventors' rate of tax. The tax treatment in all cases is the same and either provides incentives or disincentives for investment in agriculture.

Investors commencing their own commercial agricultural operations are subjected to the same tax regime as an investor in an MIS. An argument exists for the Commonwealth Government to provide more tax incentives and tax relief to encourage investment in Australian agriculture either through MIS or for individuals to operate their own farming operations.

It is Maccacorp's view that the tax treatment of MIS is similar to the tax treatment for investors commencing their own farming operations and the use of product Rulings provides certainty for investors.

## 3 ANY CONFLICTS OF INTEREST FOR THE BOARD MEMBERS AND OTHER DIRECTORS

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| The law relating to conflict of interest applies equally to directors of MIS or any other corporation in accordance with *Corporations Act 2001* (Cth). |

Directors of companies involved in MIS are subject to the provisions of *Corporations Act 2001*("the Act"). These provisions apply equally to any corporation in any industry. In addition to the provisions of the Act, MIS directors are subject to the licence conditions of the Financial Services Licence and are subject to close scrutiny by Australian Securities and Investments Commission (ASIC).

It is the view of Maccacorp that any conflict of interest for board directors should be resolved in accordance with the requirements of the Act and the policies and procedures of the board. This is effectively the basis for good corporate governance in any company regardless whether it is operating in an MIS environment or under any other corporate structure.

## 4 COMMISSIONS, FEES AND OTHER REMUNERATION PAID TO MARKETERS, DISTRIBUTORS, RELATED ENTITIES AND SELLERS OF MIS TO INVESTORS (INCLUDING ACCOUNTANTS AND FINANCIAL ADVISERS

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| Commissions paid to accountants and financial advisers are include in the Product Ruling issued by Australian Taxation Office and should not be varied. |

The fee structure of an MIS usually consists of an initial once off fee and an ongoing annual rental and management fee. The initial fee is charged to assist with the cost of preparing the land for planting, installing irrigation and planting trees. This is similar to the establishment of conventional non forestry property where initial expense is incurred to establish the property. The advantage of the MIS over an individual is that it can access economies of scale in establishment with the ongoing fees meeting operating costs and ensuring project viability.

Commissions, fees, and other remuneration paid to marketers, distributers, related entities and sellers of MIS products should be strictly in accordance with fees contained in the product Ruling as issued by the Australian Taxation Office. Payment of fees in excess of those defined in the Product Ruling should be illegal as they distort the economics of an MIS and encourages advisers to provide advice to investors based on returns to the adviser and not on the benefits of the scheme to the investor.

## 5 THE ACCURACY OF PROMOTIONAL MATERIAL FOR MIS, PARTICULARLY INFORMATION RELATING TO CLAIMED BENEFITS AND RETURNS (INCLUDING CARBON OFFSETS)

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| Promotional materials are governed by the provision of the *Trade Practices Act 1974* (Cth) and reviewed by ASIC. |

All promotional material should be accurate and not misleading or deceptive. The penalties contained in the *Trade Practices Act 1974* (Cth) are considered by industry to be adequate and generally believed to be effective. The provisions of this Act relate to all corporations regardless of industry.

ASIC have the power to review promotional material and seek removal of any misleading or inaccurate material. It is considered that the current legislation is adequate to ensure accuracy of promotional material. In addition, all projects are usually subject to external scrutiny by independent research houses that rate the project and produce reports which are for a fee available to both financial advisors and investors.

The regulatory regime relating to MIS projects is at least the same, if not greater, than that applying to other industries and is considered adequate to ensure promotional material is accurate.

## 6 THE RANGE OF INDIVIDUALS AND ORGANISATIONS INVOLVED WITH THE SCHEMES, INCLUDING THE HOLDERS OF THE RELEVANT AUSTRALIAN FINANCIAL SERVICES LICENCE

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| In accordance with the *Corporation Act 2001* (Cth) the responsible entity of a MIS is a public company and the holder of the Financial Services Licence. There is no one model for the range of individuals and organisations involved in the schemes. |

There are many models involving individuals, trusts, companies and joint ventures that_Services Licence and contractual arrangements between the land holding company and a management company. Investors in the scheme tend to be seeking a long term relatively low risk investment and have used a range of investment vehicles from individuals to companies and superannuation funds. It is interesting to note that superannuation funds have been one of the single biggest investors in the scheme indicating that the investment is seen as long term and not tax driven. The Responsible Entity (RE) must be a public company and the holder of a Financial Services Licence.

The structure of each scheme determines the range of entities involved and the structure adopted by the investors. In the case of Maccacorp the structure of the scheme has been kept simple with the RE holding the Financial

## 7 THE LEVEL OF CONSUMER EDUCATION AND UNDERSTANDING OF THESE SCHEMES

In all cases, investors should be subject to adequate consumer education and fully informed, based on their individual circumstances, by licensed financial advisers..

While it can be argued that there is a limited consumer knowledge of these schemes, how they work and the long term financial implications of investing, probably the more important question to ask is "whose responsibility is it to provide the investors with the 'in-depth education' required to fully understand a scheme? While the scheme provider is required to publish a PDS containing the structure, and financial obligations of those involved, the understanding of how they relate to the particular circumstances of the investors is the responsibility of the financial advisor and, ultimately, the investor themselves.

To assist advisors in educating their client there are number of independent review houses which review projects, in terms of not only their financial viability but also the veracity of the claims made by the scheme operators and operator competency. These reviews, for a fee, are available to financial advisors and are designed to provide the additional information required by the advisor and client to make informed decisions as to the suitability of investing in a scheme for that particular client.

While much has been made about the lack of education and understanding of MIS schemes by investors, it could be argued that the level of understanding is probably no worse than the understanding of the share market and, possibly, considerably less than investing in for example derivatives. In the last few years large amounts of money have been lost in these areas and this also could be attributed to a lack of consumer understanding of these investment vehicles.

## 8 THE PERFORMANCE OF THE SCHEMES

MIS can access economies of scale which can attract a level of investment and offset the additional costs associated with such a scheme.

The cost of an MIS scheme is higher than the cost of setting up a traditional non forestry operations since the company must comply with the provisions of the *Financial Services Reform Act 2001* (Cth). Few traditional businesses have used MIS due the complexity and cost of establishing a scheme as there is a high initial cost of first obtaining a licence and then the ongoing compliance costs of maintaining an AFS licence or employing a Responsible Entity. These costs can be substantial and most traditional businesses do not have the capital or capacity to undertake such a process. The complexity of the process is also quite daunting and is probably outsides the bounds of normal experience of most traditional rural enterprises. In addition the independent auditing of schemes by external experts as to the agricultural progress of the scheme, the legal compliance, the financial audit processes and the establishment of compliance committees adds extra cost to the MIS.

Most traditional finance for agriculture has come from the banking sector, and in particular the rural banks that were a feature of State governments, last century. The demise of these financing mechanisms coupled with greater profitability and reliability for banks from other sectors of the economy is possibly one of the contributing reasons for declining investment in the rural sector.

In contrast, large companies have invested in the rural sector as they have been able to finance the purchase of large properties and or property amalgamation costs and then provide the associated additional investment that has resulted in financially viable and sustainable operations. These investments have also provided a level of financial security as land costs over time in many areas have risen with or exceeded inflation thus minimising risk.

The risks, climatic and weather, assumed by MIS participants are the same as those assumed by people engaged in traditional agricultural enterprises as are generally the risks associated with selling the products. However, many MIS schemes have attempted to reduce the risks to investors associated with selling and marketing the product by establishing off-take agreements with processors or supermarkets. These agreements can take many forms but generally guarantee that products generated by the MIS will be sold.

Maccacorp has reduced the risk of crop failure to the individual investors by pooling and distributing yield from all orchards. This minimises the investors risk exposure as should a problem occur on one orchard, such as hail damage, they will still get some return from the overall pool. In contrast, many traditional operators only own one property and should problems arise then their exposure to risk can be substantial.

Maccacorp has entered into a long term take off agreement with the largest processor and marketer of macadamia nuts in Australia The structure of the MIS provides that all proceeds form the sale of product are returned to the grower investor

Production per employees is usually higher with an MIS compared to privately owned farms. In addition, the increased equipment available to an MIS is a reflection of the higher investment in MIS managed properties.

Non Forestry MIS projects encounter the same challenges as traditional operations in respect to site selection, establishment, access to water and maintenance of the property and equipment. The advantage that an MIS has over smaller traditional operators is the economies of scale that allow for the engagement of professional services to provide for example, worlds best practice irrigation design, soil analysis and fertiliser programs, pest monitoring and other services. The continued use of external consultants in this manner is considered both appropriate and necessary by Maccacorp's management to ensure a MIS project keeps pace with industry best practice thus maximising returns to the investor.

## 9 THE FACTORS UNDERLYING THE RECENT SCHEME COLLAPSES

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| Access to water is the critical issue with company operating in the agricultural sector. The level of debt in any business is critical especially in a market downturn. |

Currently both Great Southern and Timbercorp are under administration and it is unclear the reasons for the collapse of their schemes.

However, two issues that on the surface appear to be significant in the success of agricultural operations are firstly access to reliable water supplies and secondly the level of debt that some companies may have created.

With regard to water access to and availability of reliable water supplies is, in our opinion, paramount to the viability of farming operations. Schemes that are dependant on water from the Murray and the Darling Rivers have significant risk exposure. In contrast to operators in the Murray Darling MIS operators in the Bundaberg region usually have at least two sources of water (dams, rivers, and/or government allocated water - IWS) and consequently have a much lower risk profile.

The second issue is the level of debt that some large companies, particularly some publically listed companies, have entered into in attempts to provide ever increasing level of profit to underpin their share price. A position that is not unique to MIS schemes.

## 10 THE PROJECT RETURNS AND SUPPORTING INFORMATION, INCLUDING ASSUMPTIONS ON PRODUCT PRICE AND DEMAND

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| Independent research houses use sensitivity analysis to provide a range of product price and demand scenarios to determine project returns. |

As with all commodities the forecasting of product price and demand is not an exact science. An demand and price analysis needs to cover a range of scenarios and the longer a projection is made into the future the less accurate the projection is likely to be. While the use of industry statistics is beneficial, Maccacorp believes that will all projections a conservative approach should be always be adopted. However, investors still need to be made aware by their financial advisors as to the inherent risks with all projections and this need to be taken into account when making long term investment decisions.

*There are a range of techniques to analyse an investment available to financial advisers along with the external research provided by independent organisations. Investors should be fully informed by financial advisers as to the risks and assumption in any investment and the calculation of project returns.*

## 11 THE IMPACT OF MIS ON RELATED MARKETS

Australia needs to increase its production by more than 33% to improve its position as the largest producer and marketer of macadamias in the world.

Commodity Markets

At the beginning of 1991 some 85% of bulk Australian sales of macadamias came from the USA. During 1992 the industry focused on Asia, in particular Japan, and Europe to develop awareness of the product as an ingredient in confectionery, bakery products, snack packs and ice cream. Overseas agents and brokers were appointed to develop new business and as the industry grew more nuts the demand was created in overseas markets.

Australia has doubled the crop of 1991 and the industry now exports product to USA (35% of its sales), Europe accounted for another 30% while Asia purchased approximately 20% with the rest sold locally on the domestic market.

The following tables present industry data on production by region and sales by region

| **Region** | **Tonnage (nut in shell)** | **Tonnage (Kernel)** | **Percentage** | **Comment** |
|---|---|---|---|---|
| Australia | 40,000 | 11,000 | 42 | Quality supplier |
| Hawaii | 24,500 | 8,000 | 26 | Established supplier<br>Part of USA allowing free trade |
| South Africa | 11,000 | 2,250 | 11 | Low cost supplier<br>Quality improving<br>Roasting is an issue |
| Kenya | 5,800 | 1,250 | 6 | Low quality |
| Other | 14,700 | 2,500 | 15 | |
| Total | 96,000 | 25,000 | | |

| Geographic Region | Product | % | Opportunities |
|---|---|---|---|
| Europe | Snack Packs | 30 | Expansion into Spain, UK, Scandinavia, Holland, France, Italy, Middle East and India<br>Market is attractive |
| USA | Confectionery Bakery Products | 35 | Direct marketing to consumer<br>Improved knowledge of consumers |
| Australia | Raw & commercial grade | 15 | Mostly raw kernel for use in chocolates or snack packs |
| Asia | Raw kernel Confectionery | 20 | Nut in shell to China<br>Tight specification product for Japan |

There are about 700 macadamia farms in Australia, varying in size from 200 trees to huge plantations in excess of 50,000 trees. At an average of 250 trees per hectare there are approximately 3 million macadamia trees planted in Australia, of which some 70% are mature, yielding at least 15 kg of nut-in-shell per tree annually. The following table provides nut-in-shell production estimates to demonstrate the growth of the industry.

| Year | Tonnes NIS |
|---|---|
| 1987 | 4400 |
| 1988 | 5200 |
| 1989 | 6800 |
| 1990 | 12000 |
| 1991 | 10000 |
| 1992 | 13000 |
| 1993 | 14500 |
| 1994 | 19000 |
| 1995 | 17500 |
| 1996 | 20500 |
| 1997 | 25400 |
| 1998 | 24500 |
| 1999 | 33000 |
| 2000 | 29100 |
| 2001 | 34400 |
| 2002 | 29500 |
| 2003 | 34000 |
| 2004 | 43000 |
| 2005 | 33500 |
| 2006 | 43900 |
| 2007 | 41800 |
| 2008 | 38000(est) |

Australia needs to increase its production by more than a third to maintain its position as the largest producer and marketer of macadamia nuts. The industry, whilst it has attracted investment form smaller operators, has not until recently attracted investment by large corporations. The use of MIS by agricultural companies provides access to funds that have enabled continued expansion of the industry.

## 12 THE NEED FOR LEGISLATIVE OR REGULATORY CHANGE

It is the opinion of Macccorp that there is a need for regulatory change relating to financial advice and the level of commissions.

The first area requiring regulatory change is the payment of fees to financial advisors. Some MIS operators pay higher fees to attract sales. Fees paid to financial advisers should be fixed as a percentage of the unit investment cost and detailed in the Product Ruling. The payment of fees should be subject to the external audit and advice provide to ASIC as part of the audit submission.

There also needs to be a requirement for disclosure of fees paid by schemes to advisors to attend publicity events or to assist with the preparation of 'promotional material'. This legislative change would ensure greater transparency in the retailing of MIS products to the community.

The second area for legislative change relates to changes in the fee structure in MIS schemes so that they move from a flat fee structure towards a structure which is more performance based. While application fees need to be set at a level where they cover the establishment costs of the crop, the ongoing management fees need to be set at a level where they cover industry average production costs for an industry average crop. Additional fees then can be charged as a percentage of profit where the manager exceeds the industry average production. This would ensure the risks and performance are proportionally shared among the participants with the fees covering the cost for average production ensuring scheme viability, minimal risk to either investor or manager, but with managers receiving additional profits only if they exceed average production. This would incentivise managers to strive for world's best production thus maximising returns to investors.

The third regulatory area would be to confine non forestry MIS to export orientated or import replacement crops. This would minimise the perceived disruption to industries which are domestically focussed from the entry of MIS schemes. For example, the non forestry MIS schemes (NFMIS) could be limited to commodities where >50% of the product is exported or to industries where >50% of a product is imported. The level of exports/imports could be determined using historical and projected ABARE data for any given industry with the potential for future MIS schemes in a given commodity being withdrawn once less than 50% is exported and or less than 50% is imported. The actual level at which the threshold is set would need to be modelled and would be a political decision. This process would need to involve not only the Australian Taxation Office but also the Department of Agriculture Forestry and Fisheries ensuring more informed decisions are made as to the suitability of NFMIS in any given sector of Australian agriculture.

Overall the effect of potential legislative would not only be to minimise the current perceived distortion created by the entry of NFMIS into domestic markets but would lead to the creation of both new export based and import replacement industries using world's best practice. This would maximise returns not only to the investor but also to the Australian taxpayer as a whole.