

Chapter 4

Investor protection issues

4.1 The other side of the committee's inquiry into agribusiness MIS is the decision of investors to fund them. Specifically, in this chapter the committee examines the following agribusiness MIS investor-related concerns:

- the advice that leads people to invest in agribusiness MIS;
- the accuracy of disclosure material provided to investors;
- the appropriateness of limiting the availability of these products to sophisticated investors; and
- educating consumers.

Advice on agribusiness MIS

4.2 While concerns about the quality of financial advice available to consumers is pertinent to a broad range of financial products and services, the committee received evidence specific to agribusiness MIS. There was particular concern about the narrow focus of some licensing arrangements under which these products were distributed, as well as interest in the role accountants played in promoting the schemes.

4.3 General concerns about advisers' remuneration and the standard of financial advice they provide are also mentioned in the following section of this report, though these issues are to be addressed more comprehensively in the committee's concurrent inquiry into financial products and services. ASIC told the committee that it would provide further guidance on potential regulatory shortcomings in this area for that inquiry. However, during the committee's public hearing ASIC did indicate that issues relating to financial advisers' remuneration structures and the quality of their advice need to be addressed.¹

AFSL holders giving limited advice

4.4 A matter of serious concern was the distribution of agribusiness MIS through dedicated sales networks operating under AFSL holders licensed to advise only on agribusiness MIS. This raised a number of questions about the capacity of licensees and their authorised representatives to ensure clients receive appropriate advice.

4.5 ASIC informed the committee that, between 2006 and 2009, 38.5 per cent of total Great Southern MIS sales and 23.6 per cent of Timbercorp sales occurred under

1 ASIC, *Committee Hansard*, 15 July 2009, Canberra, p. 116

their own AFSL.² ASIC's evidence does not describe whether any other licensees and their representatives were recommending agribusiness MIS in circumstances where they could only advise on that product.

4.6 As described earlier in Chapter 2 (paragraph 2.33), section 945A of the Corporations Act requires there to be a reasonable basis for personal financial advice, including ensuring the advice is appropriate to the individual client receiving it. FPA noted: 'We must question the quality of advice when a representative is limited to recommending only one product'.³ They added:

...it is effectively impossible to put your client first, to listen to their goals, their needs, their objectives and their aspirations, to work out their assets and liabilities, their income and expenses, to go through a process of discovery and then to deliver a solution when you have only one solution in your kit bag.⁴

4.7 Their submission also claimed that neither the regulatory regime nor consumers are able to distinguish between this model, where advisers have only one product to promote, and that where advisers can direct clients to a range of investment products. FPA said:

...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.⁵

4.8 FPA argued that the required competency levels of authorised representatives are 'way too low' and the meaning of 'financial adviser' or 'financial planner' too broad for consumers to understand the variance of services provided under that banner.⁶ They recommended that a clear definition of a 'financial planner', accompanied by higher competency requirements, be incorporated into the regulatory regime.⁷

4.9 The Institute of Chartered Accountants in Australia (the Institute) also told the committee that the current licensing arrangements need to be reconsidered:

We do not believe that, if you are providing investment advice to consumers and investors, you could adequately understand the consumer

2 ASIC, *Submission 58*, Confidential attachment, p. 66 and p. 86

3 FPA, *Submission 40*, p. 3

4 FPA, *Committee Hansard*, 15 July 2009, Canberra, p. 41

5 FPA, *Submission 40*, p. 3

6 FPA, *Committee Hansard*, 15 July 2009, Canberra, p. 39 and p. 47

7 FPA, *Committee Hansard*, 15 July 2009, Canberra, p. 46

and give them all the options if you are limited to one or two products. We do not believe that that is appropriate.⁸

4.10 CPA Australia concurred:

...we query whether financial planning advice given by a providing entity licensed to provide financial planning advice and/or deal in only one or a limited number of financial products, is appropriate.⁹

4.11 Mr David Wettenhall provided an alternative view, suggesting that the single product structure provided greater transparency:

I would not have thought that that were less of a problem where that is their only product. At least it would be fairly clear that they were, in effect, a salesperson for that product. It would be more dangerous where there is an apparently independent financial adviser who is receiving a commission, which may be a very generous commission relative to other investment products. That apparently independent financial adviser is in a much more hazardous position to ensure that he is acting in his client's best interest.¹⁰

4.12 ASIC told the committee that although it is technically possible to give proper, compliant advice when authorised to advise on a single product, they shared the concerns referred to above. ASIC stated that they were investigating relevant instances as part of their investigations into the collapses.¹¹

The role of accountants and planners

4.13 Agribusiness MIS have been distributed through the following channels, all operating under an AFS licence, either as licensees or authorised representatives of a licence holder:

- financial advisers;
- accountants; and
- authorised representatives of the scheme RE (including accountants).

4.14 ASIC informed the committee that from 2006-2009 approximately 21 per cent of Great Southern products were sold by accountants as authorised representatives of Great Southern. Financial planners operating under external licensees constituted 68 per cent, with the remainder from Great Southern employees on referral. The pattern is different for Timbercorp, with accountants predominantly from small to medium

8 Institute of Chartered Accountants in Australia, *Committee Hansard*, 15 July 2009, Canberra, p. 24

9 CPA Australia, *Submission 26*, p. 6

10 Mr David Wettenhall, *Committee Hansard*, 15 July 2009, Canberra, p. 86

11 ASIC, *Committee Hansard*, 15 July 2009, Canberra, p. 119

accounting firms selling 18 per cent and Timbercorp advisers (also accountants) selling six per cent. The vast majority of sales (76 per cent) were from financial planners.¹²

4.15 The role of accountants was of particular interest during the inquiry. Because of the tax implications of agribusiness MIS, accountants were notable when compared with other financial product advice. FPA noted:

...it is no coincidence that the tax deduction part or feature of some of these arrangements was potentially attractive to the accounting profession, who—and I do not mean any disrespect, by any measure—would necessarily see that as an opportunity to improve their client’s taxation circumstances.¹³

4.16 The Institute commented that the same provision of financial advice can be provided by professionals using different titles:

I think one of the challenges is that you have accountants who are authorised representatives who then also operate as financial planners. ... I think that is one of the challenges you have: should they be either an accountant or a financial planner? The reality is that the provision of financial advice and being a financial planner is very heavily involved with tax issues and that is why more and more accountants are becoming involved with financial planning.¹⁴

4.17 This comment reflects a broader debate about the carve-out of responsibilities between AFSL holders and accountants, and whether these are practicable in real world situations. This issue will be examined further during the committee's inquiry into financial products and services.

4.18 The Institute told the committee a very small proportion of the industry were recommending Great Southern:

...obviously there have been accountants who have advised on it, but it was probably a small proportion when you consider that at the institute we have 16,000 members who are in public practice in some shape or form and we may actually have, as far as we are aware, only 80 who are authorised at Great Southern. As a profession, a lot of responsibility is being taken by a lot of accountants and only a minority have already been advising on it.¹⁵

4.19 FPA informed the committee that it had undertaken a survey of its (financial planner) members on agribusiness MIS. Just over a third of members responded to the survey and of these, 44 per cent had recommended agribusiness MIS as a small part of

12 ASIC, *Submission 58*, Confidential attachment, p. 64 and p. 84)

13 FPA, *Committee Hansard*, 15 July 2009, Canberra, p. 40

14 Institute of Chartered Accountants in Australia, *Committee Hansard*, 15 July 2009, Canberra, pp 36-37

15 Institute of Chartered Accountants in Australia, *Committee Hansard*, 15 July 2009, Canberra, p. 25

a diversified investment portfolio. According to FPA surveys most advisers set a limit of no more than ten per cent of the portfolio to be invested in agribusiness MIS.¹⁶

Remuneration models

4.20 There have been enduring concerns that commission-based remunerative models for financial planners undermine the quality of advice they provide their clients. The issue has been the subject of considerable debate well beyond the matter of advice given to clients to invest in agribusiness MIS. At the centre of this broader debate about financial advice has been the tension between commission-based remuneration making access to financial advice more 'affordable', against the possibility that financial product recommendations are motivated by the commissions they attract rather than their suitability for the client.

4.21 The industry representative group Financial Planning Australia (FPA), many of whose representatives are remunerated by selling products on commission, have realised the capacity for perceptions created by this remuneration model to damage the reputation of the industry as a whole. FPA have indicated that they would like to see commission-based remuneration phased out by July 2012, in favour of a 'client-driven remuneration model'.¹⁷ Their position recognises that if the public perceives that financial planners are salespeople rather than professionals giving expert advice, their members who provide quality, impartial financial advice will be disadvantaged. CPA Australia supported this industry-driven shift towards more transparent fee-for-service remuneration.¹⁸

4.22 The committee will examine the effect remuneration models have on the quality of advice given to financial planning clients in its inquiry into financial products and services.

4.23 Agribusiness MIS typically paid advisers upfront commissions averaging ten per cent of the amount invested.¹⁹ Financial Planning Association (FPA) told the committee that commissions to Great Southern were five to ten per cent, with commission rebates to clients being rare.²⁰ Gunns Plantations Ltd told the committee that its standard commission rate is 8 per cent, which may sometimes increase to 10 per cent with trailing commissions.²¹ ASIC also outlined additional remunerative possibilities including bonuses for sales volume, marketing allowances, and other fringe benefits such as golf days, often called 'soft dollar' incentives.²²

16 FPA, *Supplementary Submission 40*, p. 1

17 FPA, *Submission 40*, p. 5

18 CPA Australia, *Submission 26*, p. 2

19 ASIC, *Submission 58*, p. 30

20 FPA, *Supplementary Submission 40*, p. 2

21 Gunns Plantations Ltd, *Submission 51*, p. 9

22 ASIC, *Submission 58*, pp 30-31

4.24 Looking to future arrangements, the committee heard that that introduction of the 70 per cent direct forestry investment test for forestry MIS would limit the amount of commission that could be paid.²³

4.25 The Australian Agribusiness Group (AAG) suggested that there is scope for up-front commissions to be reduced to a range of four to eight per cent.²⁴

4.26 Forestry consultant Mr David Wettenhall queried the motivation behind recommendations to invest in a loss-making scheme. Citing the 2008 Great Southern PDS, he noted:

A fairly brief analysis shows that it was proposed that investors invest \$11,400 per hectare and should expect a return of at least \$9,079 per hectare— that is, a loss of over \$2,000 per hectare. It is hard to understand why that type of loss-making enterprise was recommended to investors and indeed how it got a product ruling from the ATO. I suspect that some of the advisers do not understand the available information. There is a potential conflict of interest between the commissions and incentives paid to some of the advisers, and their consideration of the public disclosure statements has been somewhat superficial.²⁵

4.27 Other submitters noted that commissions paid by agribusiness MIS are consistent with other financial products. Rewards Group Ltd argued that up-front remuneration of six to ten per cent over the term of a long agribusiness MIS is not unreasonable.²⁶ Gunns Plantations Ltd also defended commission levels:

Critics of MIS have argued that the commissions are excessive but due to the long term nature of such investments it is believed that this rate is in line with the level of advice required. This is particularly evident when you compare the MIS commission rates to that of alternative financial products, such as managed funds/ superannuation, which offer both upfront and trailing commissions over the life of the investment.²⁷

Disclosure

4.28 Disclosure is a critical aspect of investor protection in the financial products area. The regulatory regime has been established on the basis that investment product providers have the discretion to determine the types of products they offer to consumers. This reflects a minimalist approach to regulation that promotes efficiency, flexibility and innovation in financial markets and reduces the cost of capital for

23 See for example Willmot Forests Ltd, *Submission 45*, p. 7

24 AAG, *Submission 43*, p. 4

25 Mr David Wettenhall, *Committee Hansard*, 15 July 2009, Canberra, p. 84

26 Rewards Group Ltd, *Submission 19*, p. 5

27 Gunns Plantations Ltd, *Submission 51*, p. 9

business.²⁸ Investors are in theory protected by the regulator monitoring conduct and disclosure to ensure the following:

- Investment product providers conduct themselves with fairness, honesty and competence; and
- Investors are provided with full and accurate disclosure material enabling them to make fully informed decisions.²⁹

4.29 The inquiry generated some misgivings about the manner in which agribusiness MIS were promoted to investors in disclosure material. The main concern among submitters was that information on returns to investors is either inaccurate or insufficient, including suggestions that some independent expert opinion forming the basis of scheme establishment and performance is not in fact independent. The committee also considered ASIC's role in monitoring agribusiness MIS disclosure material.

Projected returns

4.30 Returns from agribusiness MIS are determined by a combination of yield, price and the cost of the scheme's establishment, maintenance, harvest and processing. Predicting a return for investors is difficult given the variables involved, particularly the unknown effect of weather and untested sites on yields, as well as commodity price fluctuations. The performance of MIS schemes was examined in Chapter 3 at paragraphs 3.33 – 3.59, in the context of the MIS business model. Here, the committee's focus is on the availability and accuracy of information on prospective performance, conveyed to prospective investors in disclosure material.

4.31 As outlined in Chapter 2 at paragraphs 2.27 – 2.30, projections contained in an MIS product disclosure statement (PDS) are taken to be misleading if they are not based on reasonable grounds. A3P and NAFI informed the committee that forestry MIS' had been discouraged by ASIC from promoting their own anticipated outcomes, instead relying on independent research houses.³⁰ They stated:

Taken literally, RG170 does not prevent the use of long-range forecasts in offer documents. However, the plantation investment companies were left with a very real fear that ASIC would issue commercially disastrous Interim Stop Orders (ISOs) on any PDSs that contained long-range forecast returns expected from their plantation projects, with the consequence that retail forestry PDSs no longer contain prospective returns.

The information presented tends to be limited to historical trends and values, assumptions on which future returns might be based, and possible scenarios. Companies rely on the independent research houses to conduct

28 See the discussion on efficient markets theory in ASIC, *Submission 58*, pp 13-14

29 ASIC, *Committee Hansard*, 15 July 2009, Canberra, pp 116-117; ASIC, *Submission 58*, p. 14

30 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 72

their own analysis and derive indicative forecasts of yields and returns to include their ratings reports.³¹

4.32 AAG told the committee that while ASIC's guidance on projected returns was well-intentioned, it had left investors in a position where they are unable to compare annual returns with forecasts:

Today, the vast majority of MIS managers outline likely yield and price scenarios for their investments in the PDS. Yield and price information is usually provided by both the project manager and an independent expert (the latter in a separate report included in the PDS).

We believe that there should be an adjustment to ASIC's view of what 'reasonable grounds' is such that project managers should be required to include returns forecasts in PDSs. In this way it will be easy for investors to determine if annual returns are being achieved in line with forecasts. This would have to be done carefully so that a repeat of the misleading figures from the past does not occur.³²

4.33 CPA Australia told the committee that there is insufficient publicly available data on the past performance of agribusiness MIS to inform investors. They recommended that ASIC or another government body research and publish this information.³³ AAG recommended mandating disclosure about the past performance of previous schemes, subject to 'prevailing economic realities' (current prices).³⁴

4.34 The Institute of Foresters of Australia (IFA) acknowledged that:

...independent information about growth and yield of MIS plantations (and for some other plantations) is not as readily available as should be expected of such an important industry sector.³⁵

4.35 IFA noted that the establishment of the majority of MIS on cleared agricultural land made accurate predictions about productivity difficult, and more research in this area is warranted. They suggested that predictions would become more reliable as the industry matures.³⁶

4.36 One issue of concern for IFA was the speculative nature of hardwood plantation schemes:

Eucalypt plantations are a relatively recent phenomenon. Rapid expansion into new areas, not previously tested for plantation growth has led to a degree of speculation on the part of plantation developers. IFA is concerned

31 A3P and NAFI, *Submission 56*, p. 38

32 AAG, *Submission 43*, p. 6

33 CPA Australia, *Committee Hansard*, 15 July 2009, Canberra, p. 22

34 AAG, *Submission 43*, p. 5

35 IFA, *Submission 42*, p. 8

36 IFA, *Submission 42*, p. 8

that some schemes are thus using investor funds to conduct broad scale experiments for plantation suitability. Examples include areas in the Wimmera region of Victoria, Esperance region of WA far north east of Tasmania and some parts of northern NSW. In addition, tropical forestry schemes such as for African mahogany and teak plantations may demonstrate high growth, but markets are uncertain compared to established markets for blue gum woodchips or pine sawlogs.

In regard to the above issues, the IFA is aware that there have been some instances where growth rates forecast and then verified by Independent Foresters for MIS plantations have not been based on sound empirical data but have relied on a degree of personal judgment. IFA supports a more rigorous approach to justification of plantation projects in new development areas.³⁷

4.37 Macquarie Agricultural Funds Management stressed the importance of providing realistic expectations in disclosure material and told the committee that they disclosed growth rates of their forestry schemes every two years.³⁸ However, A3P and NAFI indicated that it was difficult to test the validity of forestry MIS projections as many of the schemes had not yet been harvested.³⁹

4.38 The committee previously discussed the high cost nature of the agribusiness MIS model at paragraphs 3.40 – 3.48. WGGA recommended that (vineyard MIS) prospectuses be required to include disclosure of the comparative commercial cost of per hectare development and pricing assumptions.⁴⁰

4.39 More broadly, A3P and NAFI stated (sub exec summary, p. ii) that disclosure to investors in forestry MIS could be improved by:

- disclosing how investor funds are paid to contractors for plantation services;
- disclosing the financial capacity of the RE to deal with fluctuations in MIS sales; and
- disclosing more prominently the inherent risks associated with investing in agricultural enterprises.⁴¹

37 IFA, *Submission 42*, p. 9

38 Macquarie Agricultural Funds Management, *Committee Hansard*, 15 July 2009, Canberra, p. 91

39 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 68

40 WGGA, *Submission 44*, p. 6

41 A3P and NAFI, *Submission 56*, Executive summary, p. ii

'Opinion for hire'

4.40 Independent experts are a critical element of an RE's decision to establish a project and the subsequent claims they make in disclosure material to potential investors. There were, however, questions raised with the committee about the independence of the advice provided by these experts. Although the committee is focusing on disclosure to investors here, the following is closely linked with the examination of scheme performance and the revenue assumptions underpinning agribusiness MIS contained in the previous chapter.

4.41 From a yield perspective, Mr Rod Davies told the committee that competitive pressures may influence soil assessments conducted prior to the establishment these schemes:

There is an amount of competition amongst these surveyors in Australia and if a surveyor turns up to a property and does not give the answers that is expected it can perhaps be made quite plain that there will not be any more work forthcoming for that surveyor.⁴²

4.42 Mr Davies indicated that investors are given insufficient information on the process underpinning expectations of the scheme's success:

In a mining prospectus you are made very aware of the background, the qualifications and the relevant experience of the experts. In Timbercorp statements none of this detail is made available.⁴³

4.43 In relation to a horticulture project's PDS, he noted:

The PDS that I have read contains an independent horticulturalist's report. That report references soil information and then makes a note of which company might have collected that soil information. Without the individual surveyors being identified and the amount of experience they have, their technical background, being provided to a reviewer, they have no way of knowing [the experience and knowledge of the surveyor]. Similarly, the orchard expert needs to be identified, and their experience.⁴⁴

4.44 Dr David McKenzie suggested that it would be beneficial for ASIC to utilise a soil scientist to assess whether claims in agribusiness PDS' are misleading.⁴⁵

4.45 A3P and NAFI noted that agricultural risk is always present when predicting forestry yield:

...even if you have the best advice in the world there is still an agricultural risk that you are entering into. If there is not—if this was some guaranteed

42 Mr Rod Davies, *Committee Hansard*, 15 July 2009, Canberra, p. 56

43 Mr Rod Davies, *Committee Hansard*, 15 July 2009, Canberra, p. 53

44 Mr Rod Davies, *Committee Hansard*, 15 July 2009, Canberra, p. 57

45 Dr David McKenzie, *Committee Hansard*, 15 July 2009, Canberra, p. 56

return—then you would not be entitled to your tax deduction. Even the best forester may get it wrong, or rainfall may be lower than expected.⁴⁶

4.46 IFA said that claims in PDSs should be subject to appraisal from a certified forester before their release, in addition to scheme performance through the growing cycle and at completion.⁴⁷

ASIC monitoring

4.47 ASIC informed the committee that it had conducted 67 'surveillances' into agribusiness MIS over the previous three years. The measures ASIC took included requiring defective (often misleading) PDS' to be rectified with supplementary material, issuing stop orders on misleading PDS', communicating their concerns to the RE and in one instance having the PDS removed from being offered to investors.⁴⁸

4.48 The committee was also given information about ASIC's disclosure campaign following the collapse of Timbercorp and Great Southern, which assessed all 20 agribusiness MISs being marketed preceding 30 June 2009. The campaign focussed on disclosure of RE viability, including the consequences of RE collapse and RE capitalisation to meet future obligations; whether the RE is relying on future MIS sales to meet future financial obligations; and information about project yields.

4.49 According to ASIC, the outcome of this campaign was as follows (sub p. 34):

ASIC requested improved disclosure for 12 MISs operated by the seven largest participants in the sector. Each operator was required to provide better disclosure to address some or all of the issues [outlined above]. In agreeing to provide updated disclosure, 7 MIS operators were all required to give previous applicants to the projects the opportunity to withdraw their applications.⁴⁹

4.50 In evidence ASIC told the committee that this work was conducted in accordance with their powers under the Corporations Act (see Chapter 2). However:

...it does not extend as far as looking at the underlying business model and whether commercially it may or may not work; in other words, whether there are commercial risks inherent in it so that the model may not work. That is really underpinned by the legislation. It does not extend as far as ASIC regulating business models themselves.⁵⁰

46 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 70

47 IFA, *Submission 42*, p. 13

48 ASIC, *Submission 58*, pp 32-33

49 ASIC, *Submission 58*, p. 34

50 ASIC, *Committee Hansard*, 15 July 2009, Canberra, p. 110

4.51 The committee received evidence claiming that ASIC had not appropriately dealt with disclosure material that failed to inform potential investors about the real commercial cost of the activity for which they were being charged.

4.52 Section 1013E of the Corporations Act stipulates that a PDS contains information that could reasonably be expected to have a material influence on a decision to invest. Mr Kerin Smart stated that ASIC had not enforced this provision.⁵¹ Delegate Station Pastoral Company said that ASIC (and the ATO) needed to 'review their lack of action and accountability as to the integrity of information provided to investors by promoters'.⁵²

4.53 Mr David Cornish was critical of ASIC for not acting on concerns about 'the unusual business practices' of Great Southern when it purchased wood internally 'at inflated prices' in 2005, supposedly to shelter MIS sales from investor scrutiny. Mr Cornish stated:

Given this was public knowledge at the time the question must be asked why did ASIC turn a blind eye to these facts when it was first raised. It is concerning that ASIC waited until the company had fallen over and shareholder and investor had lost substantial amounts of money before investigating these issues.⁵³

Other investor protection

4.54 Protecting investors by preventing RE collapse via close prudential regulation and protecting their interests after a collapse were discussed in the previous chapter. Other alternatives include limiting the availability of agribusiness MIS for unsophisticated investors and helping investors to be better informed when making decisions. The committee addresses these issues briefly here, particularly as they relate to agribusiness MIS; however, they are not limited to this investment category. The challenge of protecting investors from making poor investment decisions generally will also be the subject of closer examination as part of the committee's inquiry into financial products and services.

Limiting product availability

4.55 A potential problem with the disclosure-based regulatory approach occurs when the products being marketed are too complex for unsophisticated investors to be in a position to make an informed decision about them, even where the relevant disclosure requirements are met. This raises the question of whether some products should be limited to institutional or sophisticated retail investors, with the

51 Mr Kerin Smart, *Submission 60*, p. 3

52 Delegate Station Pastoral Company, *Submission 50*, p. 3

53 Mr David Cornish, *Submission 54*, p. 2

consequential effect of reducing the efficiency of the market and potentially raising the cost of capital.⁵⁴

4.56 This issue of unsophisticated investors being permitted to invest in complex or risky financial products will be examined in greater detail in the committee's inquiry into financial products and services. ASIC suggested that this is a reasonable question for the committee to be investigating:

It is about whether there needs to be greater thought about whether some of these products are not suitable for investors and whether greater protection for retail investors might be needed in the future.⁵⁵

4.57 In the context of agribusiness MIS, evidence suggests that investor losses through these investments have not been as catastrophic to the individuals affected as they have been in unlisted, unrated debenture products or margin loan products. ASIC noted in evidence:

We should not assume that we are talking about mum and dad investors here as we are in Storm and some of the other things that ASIC and this committee has talked about.⁵⁶

4.58 ASIC informed the committee that 89 per cent of Great Southern investors and 80 per cent of Timbercorp investors (between 2006 and 2009) had less than \$100,000 invested in the schemes. In Great Southern schemes the median investment is \$24,000 and the mean investment \$50,000, and for Timbercorp this was \$37,500 and \$71,318 respectively.⁵⁷

4.59 They suggested that a lot of investors in Timbercorp and Great Southern would have known about the speculative nature of the investment but were prepared to 'punt the risks' to obtain a tax benefit.⁵⁸ In other words, investors have not lost the same proportion of their life savings in agribusiness MIS as other types of investment products, which would negate any argument for limiting its availability to retail investors.

Education

4.60 When investors suffer losses as a consequence of corporate collapse, attention invariably turns to whether people need to be better educated about avoiding financial products that are unsuitable for their needs. In evidence to the committee, ASIC provided the now customary warnings that investors should understand the investment risk of any given product and the pricing of this risk, as well as the importance of

54 See the discussion on efficient markets theory in ASIC, *Submission 58*, pp 13-14

55 ASIC, *Committee Hansard*, 15 July 2009, Canberra, pp 109-110

56 ASIC, *Committee Hansard*, 15 July 2009, Canberra, p. 115

57 ASIC, *Submission 58*, p. 16

58 ASIC, *Committee Hansard*, 15 July 2009, Canberra, p. 118

spreading their investment risk across diversified asset classes.⁵⁹ The extent to which these basic principles of investment are being received, understood or heeded by retail investors continues to be a matter of concern for the committee.

4.61 Again, these issues will be examined further as part of the committee's broader inquiry into financial products and services. For this inquiry, issues of particular concern have been the level of understanding about the intent of ATO product rulings and how tax deferral mechanisms work generally.

4.62 As mentioned previously in Chapter 2, the ATO stressed that the product rulings ATO makes on agribusiness MIS include the disclaimer that the ruling does not represent a product endorsement or a guarantee of commercial viability.⁶⁰ ASIC commented that investors may not fully understand the tax implications of these investments: 'These schemes are not usually tax saved, just tax postponed'.⁶¹

4.63 CPA Australia told the committee that it had been warning about these products for some time:

...for over the last decade, we have been informing our members and the public that making an investment based on the tax deductibility features is not a very good way to make money. In fact, we have a guidance note for our public practitioner members, which we issued some years ago, on advising on agricultural managed investment schemes, to ensure that members were informed and were providing the right type of advice and looking at profitability, looking at expected chances of success and looking far beyond just that year-end tax deduction.⁶²

4.64 Unfortunately, there is little that can be done via additional disclosure material to better educate investors. Gunns Plantations Ltd highlighted the plethora of documentary information already available to potential investors. They include:

- product disclosure statements from the product issuer,
- statements of advice from financial advisers;
- ATO product rulings;
- independent expert reports; and
- reports from independent research houses.⁶³

59 ASIC, *Committee Hansard*, 15 July 2009, Canberra, p. 115

60 ATO, *Submission 18*, Attachment 1, p. 3

61 ASIC, *Submission 58*, p. 42

62 CPA Australia, *Committee Hansard*, 15 July 2009, Canberra, p. 25

63 Gunns Plantations Ltd, *Submission 51*, p. 12

4.65 A3P and NAFI also warned that providing consumers with more information may not be effective:

The level of information available to both the prospective as well as the current investor is extensive. However, regardless of how much information is available, there is no guarantee that it will be consumed, understood and acted upon. Merely providing more information will not necessarily address this limitation.⁶⁴

4.66 AAG suggested that investors may not comprehend the nature of agricultural risks:

Agribusiness MIS are inherently risky and have a suite of risks involved that are not seen in more common asset classes (e.g. agricultural risks). We sometimes question whether some investors fully understand the structure of what they have invested in and the nature of the associated risks involved. The fact that the Promoter is engaged by the investor to do almost all of the actual farm work, distances the investor from these agricultural realities.⁶⁵

4.67 However, they indicated that 'there is really no excuse' for investors and advisers to have not performed adequate due diligence on the investment.⁶⁶

4.68 Willmot Forests Ltd suggested that the disclosure of agribusiness MIS investment risk could be 'elevated':

...the special risks associated with agricultural enterprises and investments should receive greater prominence in required documentation and reports.⁶⁷

4.69 CPA Australia told the committee that more needed to be done to ensure that investors understood risk, along with the fact that disclosure material approved by ASIC or a product ruling from the ATO does not guarantee success. They recommended that ASIC:

- undertake a marketing campaign promoting their educational FIDO website; and
- conduct annual benchmarking to track the progress of FIDO reach.⁶⁸

64 A3P and NAFI, *Submission 56*, p. 28

65 AAG, *Submission 43*, p. 4

66 AAG, *Submission 43*, p. 4

67 Willmot Forests Ltd, *Submission 45*, p. 7

68 CPA Australia, *Submission 26*, p. 8

Committee view

Advice

4.70 The committee's principal concern stemming from this inquiry is the incidence of narrow sales recommendations, limited to agribusiness MIS under some financial services licensing arrangements, being portrayed as financial advice. There must be significant doubt as to whether such advice is appropriate to the client's needs, as required by the Corporations Act, when the person offering that advice has only one type of investment product to recommend. ASIC's investigations into the way in which licensed advisers channelled clients into Timbercorp and Great Southern should provide greater clarity on this issue. More generally, ASIC's enforcement and auditing of standards of advice are matters that will be further discussed in the committee's imminent report on financial products and services.

Licensing and remuneration

4.71 The committee is also concerned that many consumers are not able to readily distinguish between this type of narrow licensing arrangement and one where financial advisers are licensed to recommend a much broader range of products. One size fits all licensing is part of the broader problem of a lack of clarity between product sales and tailored financial advice, compounded by commission-based remuneration models. The committee recognises that disquiet over remuneration for recommending agribusiness MIS mirrors wider concern that conflicted advice is being given about a range of financial products that pay commissions to advisers. There do not seem to have been any issues in this regard that are unique to the advice that was given about agribusiness MIS. Indeed, the tax considerations inherent in recommending agribusiness MIS probably diminish the effects of the remuneration models they use. The committee will examine licensing and remuneration matters in greater detail as part of its inquiry into financial products and services.

Disclosure

4.72 A concern specific to agribusiness MIS was the accuracy of disclosure material available to investors, especially in relation to predicted scheme performance. Given the lack of historical data relevant to many of these enterprises and the variability of agriculture generally, the committee recognises that achieving a balance between providing useful information and limiting the potential to mislead investors is a difficult one. It is therefore reluctant to make prescriptive recommendations on disclosure for agribusiness MIS. However, the committee is of the firm view that the unique nature of agribusiness MIS necessitates that ASIC closely monitors relevant disclosure material for misleading content, without being prompted by complaint or investor loss. A more rigorous approach would include ensuring that historical data is presented in the context of variable prices and climatic conditions; the commercial cost of the activity is disclosed against the MIS cost and relevant third party contracting arrangements; and the qualifications of independent third parties used to justify claims about scheme performance are disclosed.

4.73 The committee was especially concerned about the potential for less qualified opinion about scheme performance, particularly relating to yield, to be favoured over those more qualified, because they are able to be persuaded to provide a generous assessment that will provide greater appeal to investors. Investors sensibly place more weight in the opinion of those most qualified to provide it, not only because it comes from knowledge and experience, but there exists more of an incentive to meet peer expectations of rigour and independence. The committee therefore recommends that ASIC require agribusiness MIS to disclose the qualifications and accreditation of third parties that provide expert opinion on likely scheme performance.

Recommendation 3

4.74 That ASIC require agribusiness MIS to disclose the qualifications and accreditation of third parties that provide expert opinion on likely scheme performance.

Limiting products and educating consumers

4.75 Finally, the committee notes that the inquiry elicited comment on limiting investment products and better educating consumers about making sensible investment choices. The committee agrees that certain investment products may not be suitable for unsophisticated investors and will examine their regulation in the financial products and services inquiry, though it is not of the view that agribusiness MIS falls into this category. The critical element of protecting investors purchasing agribusiness MIS is educating them to ensure that they invest as part of a diversified asset portfolio with a level of financial risk appropriate to their circumstances. These basic principles will not prevent investor losses from business failure but can greatly mitigate their effect. Again, the committee recognises that this is an issue not limited to decisions about agribusiness MIS, and will therefore investigate it more closely as part of its financial products and services inquiry.

Mr Bernie Ripoll MP

Chairman