



Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into aspects of agribusiness managed
investment schemes

September 2009

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* Please note that Senator the Hon Brett Mason (**Deputy Chair**; QLD LP) remains a member of the committee but did not participate in this inquiry.

* Senator Gavin Marshall (VIC, ALP) was a member of the committee during this inquiry, until 24.06.09. Senator McLucas was appointed to the committee on this same date.

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

- (a) to inquire into, and report to both Houses on:
 - (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or
 - (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and
- (b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and
- (c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

Terms of Reference

Having regard to the recent collapses of Timbercorp and Great Southern, the Committee will inquire into and report by 7 September 2009 on agribusiness managed investment schemes (MIS), with particular reference to:

1. business models and scheme structures of MIS;
2. the impact of past and present taxation treatments and rulings related to MIS;
3. any conflicts of interest for the board members and other directors;
4. commissions, fees and other remuneration paid to marketers, distributors, related entities and sellers of MIS to investors (including accountants and financial advisers);
5. the accuracy of promotional material for MIS, particularly information relating to claimed benefits and returns (including carbon offsets);
6. the range of individuals and organisations involved with the schemes, including the holders of the relevant Australian Financial Services Licence;
7. the level of consumer education and understanding of these schemes;
8. the performance of the schemes;
9. the factors underlying the recent scheme collapses;
10. the projected returns and supporting information, including assumptions on product price and demand;
11. the impact of MIS on other related markets; and
12. the need for any legislative or regulatory change.

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Chapter 1

Introduction

Terms of reference

1.1 On 27 May 2009 the Parliamentary Joint Committee on Corporations and Financial Services resolved that:

Having regard to the recent collapses of Timbercorp and Great Southern, the Committee will inquire into and report by 7 September 2009 on agribusiness managed investment schemes (MIS), with particular reference to:

1. business models and scheme structures of MIS;
2. the impact of past and present taxation treatments and rulings related to MIS;
3. any conflicts of interest for the board members and other directors;
4. commissions, fees and other remuneration paid to marketers, distributors, related entities and sellers of MIS to investors (including accountants and financial advisers);
5. the accuracy of promotional material for MIS, particularly information relating to claimed benefits and returns (including carbon offsets);
6. the range of individuals and organisations involved with the schemes, including the holders of the relevant Australian Financial Services Licence;
7. the level of consumer education and understanding of these schemes;
8. the performance of the schemes;
9. the factors underlying the recent scheme collapses;
10. the projected returns and supporting information, including assumptions on product price and demand;
11. the impact of MIS on other related markets; and
12. the need for any legislative or regulatory change.

Conduct of the inquiry

1.2 The inquiry was advertised in *The Australian* newspaper and online. The committee invited submissions from interested organisations, government departments and authorities, and individuals. The closing date for submissions was 26 June 2009, and the committee agreed to table its report by 7 September 2009.

1.3 The committee received 60 formal submissions, along with associated correspondence and supporting material. Appendix 1 lists the individuals and

organisations that made public submissions to the inquiry, as well as tabled documents and additional information provided to the committee.

1.4 The committee held a public hearing in Canberra on 15 July 2009. Appendix 2 contains a list of witnesses who gave evidence at that hearing and responses to questions on notice taken at that hearing.

Acknowledgement

1.5 The committee thanks those organisations and individuals who made written submissions and gave evidence at the public hearings.

Note on references

1.6 References to submissions in this report are to individual submissions as received by the committee and published on the internet. References to the committee Hansard are to the proof Hansard, and page numbers may vary between the proof and the final Hansard transcripts.

Report structure

1.7 Chapter 2 outlines the structure and operation of agribusiness managed investment schemes (MIS); the Australian regulatory environment for MIS; the tax arrangements that apply to agribusiness MIS; and the current state of the sector.

1.8 Chapter 3 discusses agribusiness MIS structural issues, including the incentives for MIS investment and related market distortions; the effect of high costs and uncertain revenue assumptions on scheme performance; the ability of the MIS structure to withstand restricted access to capital; potential measures to prevent responsible entity (RE) failure; and arrangements for managing competing interests when an RE collapses.

1.9 Chapter 4 examines 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 the importance of educating consumers about investment risk.

Chapter 2

Background information

2.1 This chapter provides a brief overview of the structure of agribusiness managed investment schemes (MIS) and how they operate; the Australian regulatory environment for MIS; the tax arrangements that apply to agribusiness MIS; and the current state of the sector, including a description of the Timbercorp and Great Southern collapses.

2.2 Debates about agribusiness MIS policy issues are included in Chapters 3 and 4.

MIS structure

2.3 The term managed investment schemes (MIS) describes a variety of structures based on collective investment in a common enterprise. All MIS share the following characteristics, as defined in section 9 of the Corporations Act:

- (a) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether rights are actual, prospective or contingent and whether they are enforceable or not);
- (b) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders); and
- (c) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or give directions).

2.4 The MIS structure is used for a wide range of investment options, including cash management trusts, equity trusts and property trusts. These are generally structured as unit trusts, where investors receive a proportion of the trust's profits equal to the proportion of their units to the total number issued.¹

2.5 ASIC recently provided an overview of the sector:

The MIS is really a generic term to describe a variety of structures for the creation and operation of collecting investment schemes or projects. Basically it covers everything that involves an investor acquiring something other than a security; that is, a share or a debenture or an interest in a prudentially regulated entity such as a bank deposit, a superannuation

1 Treasury, *Review of Non-Forestry Managed Investment Schemes*, December 2008, p. 2

interest or a life interest. The sector includes things like managed funds; public unit trusts; ASX listed trusts; common funds; limited partnerships; investment pools and clubs; cash management trusts; property trusts; property syndicates; mortgage trusts; serviced strata schemes; agricultural schemes, including forestry, horticulture, viticulture; and alternative investment schemes such as horse racing syndicates, for example.

There are something in the order of 5,200 registered managed investment schemes in Australia. They are operated by 674 responsible entities. Statistics on total funds invested that are under management in these different types of MIS are not reliable but we estimate that it is around about \$350 billion. The registered MIS schemes can be listed or unlisted. We have got something in the order of 110 listed schemes. Mostly they are invested in property or infrastructure.²

2.6 Although MIS as a whole constitutes a significant portion of Australian investment, the committee's present interest is in agribusiness MIS. The regulation of this broader category of MIS products and the advice given in relation to them is not being considered as part of this inquiry.

Agribusiness MIS

2.7 Agribusiness MIS is generally split into two categories: forestry and non-forestry MIS. Forestry MIS refers to plantation forestry projects which may be ready to harvest in 8-25 years, necessitating a long period between investment and return. Non-forestry MIS generally covers a range of horticultural activities; primarily olives, almonds and wine grapes but also including macadamias, stone fruit, citrus, mangoes, avocados and table grapes.³ The wait for a return on investment in these projects differs between crops but is less than forestry MIS. However, horticulture projects are labour and capital intensive in comparison.⁴

2.8 As with other MIS, investors (or growers) in an agribusiness MIS pool their funds for a common purpose, in this case to finance large scale agricultural operations. Rather than investing in the unit trust structure outlined above, though, investors gain an interest in an agricultural project on an allocated parcel of land. Fees paid by investors secure the right to have their 'allotment' used for a particular agricultural purpose, and a limited right to what is grown on that land by the scheme's manager, operating under a management agreement.

2.9 Investors do not purchase a physical asset, including the land the projects occur on. In forestry MIS, the growers usually own the trees on the land, while growers in non-forestry MIS are entitled to the crop but not the trees that produces it.

2 Senate Economics Committee, *Estimates Hansard*, 4 June 2009, Canberra, pp 89-90

3 ASIC, *Submission 58*, pp 18-19. Non-forestry MIS can also include beef, poultry and aquaculture.

4 ASIC, *Submission 58*, pp 19-20

Investors receive a share of harvest proceeds after the scheme's manager has been paid for plantation/crop maintenance, harvesting, land costs and selling the crop.⁵ The harvest proceeds are pooled and distributed to investors in proportion to the number of 'allotments' of land they hold.⁶

Responsible Entities (RE)

2.10 Agribusiness MIS are operated by a Responsible Entity (RE) in accordance with the scheme's constitution and the conditions attached to their Australian Financial Services Licence (AFSL). The *Managed Investments Act 1998* introduced the single RE structure in place of the previous dual party structure where responsibility was shared between a funds manager and trustee.⁷ The regulation of REs is outlined further from paragraph 2.17.

2.11 Prior to raising funds from investors, the RE acquires land for the purpose of establishing MIS projects. The land may be sourced via a number of arrangements, including:

- the RE purchasing the land freehold;
- a leasehold arrangement where rent is paid to a third party for the life of the project; or
- a sale and leaseback arrangement that moves debt off the RE's balance sheet but necessitates rent payments to the landholder.

2.12 Whichever approach is taken, the RE is required to meet land (and associated water rights) costs through either servicing debt or rental payments.⁸ The RE and the landholding company will often be related through a common parent company.⁹

2.13 The land is subleased to investors in small allocations and the agribusiness project managed on behalf of investors in accordance with management agreements. These are generally standard for all investors via a master agreement to which all investors are attached. The fees investors pay the RE for managing the MIS project are described below.

2.14 Once capital for the project has been raised, the RE enters into an agreement with an operations manager to oversee the on-the-ground operational requirements of

5 These activities are often contracted out to another entity.

6 Treasury, *Review of Non-Forestry Managed Investment Schemes*, December 2008, p. 2; ASIC, *Submission 58*, p. 20

7 Parliamentary Joint Committee on Corporations and Financial Services, *Report of the review of the Managed Investments Act 1998*, December 2002, p. 5

8 Macquarie Agricultural Funds Management, *Submission 48*, p. 7

9 ASIC, *Submission 58*, p. 27

the project such as cultivation, maintenance and harvest. These tasks are usually undertaken by third parties under subcontracting arrangements. The RE, operations manager and (less commonly) those contracted to undertake work on the project may be related entities.¹⁰

Fee structures

2.15 The fee structures paid by investors in agribusiness MIS differ between forestry and non-forestry MIS. Non-forestry MIS charge investors an up-front fee and additional annual fees for rent and management of the project. These annual fees may be paid out of net proceeds from harvests once crops begin to yield. In the case of forestry MIS, the lag time between establishing the project and harvest is much longer. Typically, annual project costs are incorporated in the up-front fee or deferred until plantations are harvested and growers receive their share of the proceeds.¹¹

2.16 The reason for this distinction is attributable to the marketability of the MIS. Selling forestry MIS where investors need to make annual payments without receiving any income proved difficult and led to a reliance on up-front payments. However, the practice of securing funds up-front to meet long term and continuing operational requirements, and deferring maintenance and rental fees until harvest, creates cash flow issues for the RE that are discussed in the next chapter.

MIS regulation

2.17 Agribusiness MIS are regulated by the Australian Investments and Securities Commission in accordance with the Corporations Act.

Specific legislative requirements

2.18 Chapter 5C of the Corporations Act regulates the operation of an MIS. Section 601ED of the Corporations Act requires that an MIS with more than 20 members be registered with ASIC, if intended to be sold to retail investors. A registered MIS must be operated by a Responsible Entity (RE) under section 601FB. The RE is required to be a public company and hold an Australian Financial Services Licence (AFSL) under section 601FA.

2.19 Section 601EA(4) stipulates that registered schemes must have a scheme constitution and a compliance plan. Section 601GA requires that the constitution sets out the rights and obligations of MIS members and the RE. The requirement to have a scheme constitution generally takes the form of a contract (management agreement) between the RE and its members.¹² Section 601HA provides that the compliance plan must set out the measures the RE will take to ensure that it is complying with the

10 Treasury, *Review of Non-Forestry Managed Investment Schemes*, December 2008, p. 27

11 ASIC, *Submission 58*, p. 21

12 Treasury, *Review of Non-Forestry Managed Investment Schemes*, December 2008, p. 25

Corporations Act requirements and its constitution. Section 601HG requires the compliance plan to be audited annually and lodged with ASIC. Under section 601JA the RE must establish a compliance committee to monitor adherence to the compliance plan, where fewer than half the RE's directors are independent.

2.20 The duties of a RE are contained in section 601FC of the Corporations Act. They include:

- acting honestly and exercising the care and diligence of a reasonable person in the RE's position; and
- acting in the best interests of members and give priority to members' interests over those of the RE where there is a conflict between the two.

2.21 A3P and NAFI informed the committee that forestry MIS companies mostly use wholly-owned subsidiaries as the RE, while some employ an external group for this purpose.¹³

Australian Financial Services Licence (AFSL) conditions

2.22 As AFSL holders, REs for agribusiness MIS are also subject to a number of general obligations contained in section 912A of the Corporations Act. These include:

- providing the financial services covered by the licence efficiently, honestly and fairly;
- having adequate arrangements in place to manage conflicts of interest;
- complying with licence conditions and financial services laws, including taking steps to ensure compliance by representatives;
- having adequate resources to carry out the services covered by the licence;
- maintaining competence to provide these services, including the competence of representatives;
- having a dispute resolution mechanism for retail clients; and
- having adequate risk management systems.

2.23 AFS licences are granted and administered by ASIC, which also supervises the conduct of REs in complying with their licence conditions. ASIC informed the committee that:

13 A3P and NAFI are the Australian Plantation Products and Paper Industry Council and the National Association of Forest Industries respectively. A3P and NAFI, *Submission 56*, p. 16

This supervision is done on a risk-assessed basis, and will often be triggered by a breach notification from the RE, a report from a compliance plan auditor or compliance committee, a complaint, or ASIC's targeted supervision of entities or sectors identified as problematic.¹⁴

Disclosure requirements

2.24 Investment products available to retail clients, including agribusiness MIS, are subject to the disclosure requirements set out in Chapter 7 of the Corporations Act. This includes the requirement to provide a Product Disclosure Statement (PDS). The disclosure requirements for financial advisers recommending MIS are described below. ASIC is responsible for monitoring and enforcing the disclosure requirements of the Corporations Act.

2.25 The information contained in PDS must be up to date (section 1012J); be worded and presented in a clear, concise and effective manner (section 1013C(3)); and must contain certain information necessary for potential investors to make an informed decision about the product, including the cost, potential benefits and risks of the investment (section 1013D). Section 1013E stipulates that the PDS is required to include 'any other information that might reasonably be expected to have material influence' on potential investors' decision about whether to invest in the product.

2.26 Aside from the requirement to provide certain information, the Corporations Act also stipulates that the PDS must not contain false or misleading statements (section 1041E) and issuers must not engage in misleading and deceptive conduct (section 1041H). ASIC also has authority under the Act to prevent the distribution of a misleading PDS via a stop order (section 739), or it may alternatively give the issuer the option of providing remedial information.

2.27 Of close relevance to agribusiness MIS disclosure is the regulatory treatment of investor return projections or forecasts in their PDS. Section 728(2) of the Corporations Act provides that statements about future matters (including projections) are taken to be misleading if they do not have reasonable grounds.

2.28 ASIC's guidance on what constitutes 'reasonable grounds' is contained in its regulatory guide on prospective financial information.¹⁵ The following underlying principle directs ASIC when assessing this issue:

The less reliable information is, the less relevant it becomes to investors, and the less likely it should be included in the disclosure document or PDS.

We think that prospective financial information based on hypothetical assumptions (rather than reasonable grounds) is likely to be misleading and provide little information to investors.¹⁶

14 ASIC, *Submission 58*, p. 12

15 ASIC, *Regulatory Guide 170*, 'Prospective financial information', September 2002

16 ASIC, *Regulatory Guide 170*, 'Prospective financial information', September 2002, pp 3-4

2.29 According to ASIC, the provision of prospective financial information, particularly over longer time horizons, can discount future risk variables and can mislead investors with information based on unrealistic assumptions. The guidance note indicates that independent experts' industry reports may provide reasonable grounds for providing prospective information, where their credentials and the facts they rely on to make their assessment are verifiable.¹⁷ However, the guide emphasises that the longer the period the projections relate to, the less likely the grounds for including it in the PDS.¹⁸

2.30 ASIC also states that prospective information should be accompanied by a warning about its lack of reliability.¹⁹

Financial product advice regulation

2.31 The provision of financial advice on agribusiness MIS products is also regulated by the Corporations Act. In accordance with section 766A, only entities holding an AFSL (and their authorised representatives) to provide a financial service are permitted to provide financial product advice. Section 766B(1) defines financial product advice as a recommendation or statement of opinion intended to influence a person about a decision relating to a financial product.

2.32 Section 766B(3) stipulates that where an advisor takes the personal circumstances of the client into account when giving advice, then it is deemed to be personal advice. Advice of this nature must be accompanied by a statement of advice, which discloses the advice given, the basis on which it is provided, details of remuneration, commissions and other benefits resulting from the provision of the advice, and relevant conflicts of interest that may influence the advice given.²⁰

2.33 The legislative standard of advice required under the Corporations Act is that there is a reasonable basis for the advice (section 945A). This necessitates knowing the client's circumstances, knowing the product (or subject matter) and ensuring the advice is appropriate to the client. ASIC has indicated that 'personal advice does not need to be ideal, perfect or best' to comply with the Corporations Act.²¹ Subject to meeting the disclosure requirements outlined above, advisers can therefore lawfully recommend an agribusiness MIS product knowing it is not in the best interests of the client.

17 ASIC, *Regulatory Guide 170*, 'Prospective financial information', September 2002, p. 9

18 ASIC, *Regulatory Guide 170*, 'Prospective financial information', September 2002, p. 12

19 ASIC, *Regulatory Guide 170*, 'Prospective financial information', September 2002, p. 23

20 ASIC, *Regulatory Guide 175*, 'Licensing: Financial product advisers—Conduct and disclosure', May 2009, p. 7

21 ASIC, *Regulatory Guide 175*, 'Licensing: Financial product advisers—Conduct and disclosure', May 2009, p. 34

Regulations applying in the event of a collapse

2.34 Under section 588G of the Corporations Act directors have a duty to not incur a debt where they have reasonable grounds to suspect that the company is insolvent or likely to become insolvent as a consequence of that debt. Companies are insolvent when they cannot meet their financial obligations when they fall due.²²

2.35 In the event that a company board reaches the conclusion that it is insolvent or in danger of becoming so, they may appoint a voluntary administrator to manage the affairs of the company (section 436A). After investigating the company's situation, the administrator reports to creditors on the most appropriate course of action (section 438A). One option may be for creditors to agree to the company entering into a deed of company arrangement, under which the administrator seeks to maximise the chances of the company continuing, or if this is not possible, to improve returns to the company's creditors and members than would result from an immediate winding up (section 439C).²³ Alternatively, creditors may decide to have the company immediately placed in the hands of a liquidator and wound up (section 439C).

2.36 In the context of agribusiness MIS, it should be noted that the collapse of an RE does not necessarily mean that each scheme it operates ceases to be a going concern. ASIC explained:

A MIS itself is not a legal entity; it cannot, for example, enter contracts or borrow money. The insolvency of the RE does not automatically mean the MIS that RE operates is insolvent. It is quite possible for the RE to be insolvent while the scheme itself remains a going concern.

In such a situation the Act contemplates mechanisms for the replacement of a RE or the appointment of a temporary RE. We acknowledge that the insolvency of a RE may destabilise the operation of a scheme, however it is not always the case that when the RE fails, the scheme fails.²⁴

2.37 Under section 181 of the Corporations Act the directors and other officers of a corporation must act in the best interests of the corporation. However, section 601FD(1) of the Corporations Act states that officers of a RE must act in the best interests of members. Any conflict between these obligations is resolved in favour of members under section 601FD(2). These conflicting duties are discussed in the next chapter in the context of an RE appointed as an administrator or liquidator following its collapse (paragraphs 3.99 – 3.110).

22 See section 95A of the Corporations Act.

23 See also section 435A of the Corporations Act.

24 ASIC, *Submission 58*, p. 49

Agribusiness MIS tax arrangements

2.38 The tax deductibility of expenses associated with agribusiness MIS has been subject to some uncertainty in recent years. The revised ATO interpretation, legislative amendment and court judgment are described as follows.

The MIS tax regime

2.39 Prior to 2006, the ATO had allowed up-front tax deductions for investment in agribusiness MIS under the general business deductions provisions in section 8-1 of the *Income Tax Assessment Act 1997*. The fee component of the investment was an allowable deduction on the basis that it is not considered appropriate for the ATO to dictate how much taxpayers should pay to earn an income.²⁵ In practical terms, the rule meant that investors in agribusiness MIS could defer some of their tax liability until the investment paid returns, which might occur when they had ceased to earn income in the higher tax brackets, thus minimising their overall tax liability.

ATO product rulings

2.40 To provide certainty to investors about the deductibility of their MIS investment, the ATO issues product rulings for eligible MIS projects. The ATO explained:

In response to the spread of mass marketed schemes, product rulings were introduced in 1998 to offer an avenue for potential investors to satisfy themselves about the bona fides of tax benefits claimed in the marketing of so-called tax effective investments.²⁶

2.41 The MIS operator is required to provide certain information supporting the project's profitability before the ATO will issue a product ruling:

This includes cash flow forecasts, budgeted profit and loss statements, expert reports supporting those forecasts and proposed marketing materials for the project. In order to ensure the MIS makes a significant contribution to primary production, the ATO set minimum forestry and horticultural expenditure requirements for a person's investment.²⁷

2.42 For the product ruling to be binding, the scheme must be carried out in the way described in the ruling.²⁸

2.43 The ATO stressed that these rulings are not intended to serve as a promotional tool for the MIS operator:

25 ATO, *Submission 18*, p. 1

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

27 ASIC, *Submission 58*, p. 24

28 ATO, *Submission 18*, Attachment 1, p. 4

The ATO warns potential participants to closely examine the overall financial merits of an investment product before making a decision on whether or not to invest.

We expressly caution potential participants that the ATO does not sanction or guarantee any product as an investment. We do not give any assurance that the product is commercially viable, that the projected returns will be achieved or that fees charged by managers or projected returns are reasonable.²⁹

2.44 The non-commercial loss provisions in Division 35 of the ITAA require the ATO to consider commercial viability when allowing deductions against other assessable income in the year the loss is incurred. The Commissioner is given discretion to exempt losses in business activities where there is a long lead time between the commencement of the activity and income from production. MIS projects are granted this exemption in the relevant product rulings.³⁰

Revised ATO ruling

2.45 In 2006, on the basis of previous court decisions, the ATO revised its view on the deductibility of agribusiness MIS investments altogether, not just in relation to the fee component. They determined that the amounts paid by investors constituted capital and were therefore not allowable deductions.³¹ From 1 July 2008, the ATO ceased to provide product rulings on agribusiness MIS products. It also published the view that it would administer section 8-1 of the *Income Tax Assessment Act 1997* covering general business deductions on the basis that deductions were not available for investors in these schemes.³²

Court case

2.46 Following consultation with industry a test case was run in the Federal Court to clarify the matter. In December 2008 the court found that the expenses were not in fact capital in nature and were allowable deductions incurred in carrying on a business via agribusiness MIS arrangements.³³ The consequence of the Court's decision is that investments in agribusiness MIS are subject to the same treatment by the ATO as they were prior to its revised ruling in 2006.

Forestry MIS

2.47 The exception is forestry MIS, where separate arrangements were enacted in 2007 to guarantee upfront tax deductibility for investment in that sector, often referred

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

30 ATO, *Submission 18*, Attachment 1, p. 2

31 ATO, *Submission 18*, p. 1; ATO, *Committee Hansard*, 15 July 2009, Canberra, pp 13-14

32 ASIC, *Submission 58*, p. 19

33 ATO, *Submission 18*, p. 1

to as the Division 394 arrangements. Investors in forestry MIS marketed under these arrangements are no longer required to demonstrate that they are carrying on a business. As an integrity measure, it contains a requirement for no less than 70 per cent of the payments received by forestry MIS to be used for direct forestry expenditure. This includes the costs of the land and planting, tending and harvesting the trees, but excludes costs such as management fees, administration and marketing the scheme. Other integrity measures are the requirement to establish trees within 18 months of investors entering the project and a requirement for investors to hold their interest for a minimum of four years before trading it to a secondary buyer.³⁴

2.48 Other agribusiness MIS remained subject to the ordinary tax provisions, which have since been determined according to the court's findings described above. The consequence is that investment in both forestry and non-forestry MIS are allowable deductions at present, though they now operate under different legislative provisions. NAFI explained that forestry MIS would continue to operate under the new statutory arrangements:

Despite the test case decision that effectively allows retail forestry to operate once again under the general business deduction entitlements (section 8-1 of ITAA 1997), all plantation investment companies are now operating under Division 394, and will continue to do so.³⁵

Arrangements for failed schemes

2.49 The ATO indicated that there is still some uncertainty about the tax treatment of failed schemes and that they are developing a draft tax ruling to deal with the matter.³⁶ At present, the main sources of confusion relate to:

- the tax deductibility of members' continuing payment obligations to schemes that have been wound up or operate in a different way from that described in the product ruling; and
- the application of the forestry MIS secondary trading provisions designed to prevent scheme interests being sold within the designated four year period.

Agribusiness MIS industry conditions

2.50 Agribusiness MIS in Australia has been characterised by rapid growth followed by a period of instability in the sector. The collapses of Great Southern and Timbercorp are both a reflection of, and a contributor to, this instability. The following section provides a brief outline of the state of the MIS industry today, recent trends and a preliminary explanation of the collapse of Timbercorp and Great

34 A3P and NAFI, *Submission 56*, p. 9

35 A3P and NAFI, *Submission 56*, p. 9

36 ATO, *Committee Hansard*, 15 July 2009, Canberra, pp 7-8, 19

Southern. The policy implications of the current situation are explored in Chapters 3 and 4.

Current industry conditions

2.51 ASIC provided the following information on agribusiness MIS in Australia, up-to-date as of 14 July 2009:

- There are 371 registered MIS under 70 different Responsible Entities. Of these, 198 schemes are forestry, 162 horticultural and 11 'other'.
- Agribusiness MIS have raised approximately \$8 billion since 1998 and approximately \$5 billion in the past five years.
- Agribusiness MIS represent around 3.2 per cent of the entire retail MIS industry.
- Investment in forestry MIS is just over double that raised by non-forestry MIS over the last five years.
- Of horticultural MIS, grapes (45 per cent), almonds (17 per cent) and olives (14 per cent) are the most common.³⁷

2.52 Recent industry trends have been outlined in the annual survey of the MIS sector by agribusiness research house AAG. They found that timber investments accounted for 90 per cent of total agribusiness MIS funds raised in 2008-09 and horticulture MIS raised only \$13 million, a 95 per cent decrease from the previous year.³⁸

2.53 A3P and NAFI reported that there are now fewer than ten companies offering forestry MIS products; from as many as 16 in the three years previous.³⁹ They also informed the committee that Great Southern and Timbercorp schemes account for about half the retail forestry area under management.⁴⁰

Timbercorp collapse

2.54 Timbercorp Securities Ltd (Timbercorp) was the RE for 34 registered MIS, including (by size) eucalypts, almonds, olives, citrus, avocados, mangoes and grapes. These schemes were funded by over 18,000 investors contributing just under \$1.1

37 ASIC, *Submission 58*, pp 47-49

38 Hopkins, P. 'Tough harvest ahead for agribusiness', *The Age*, 21 July 2009, accessed on 20 August 2009 at <http://business.theage.com.au/business/tough-harvest-ahead-for-agribusiness-20090720-dqu1.html>

39 A3P and NAFI, *Submission 56*, p. 7

40 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 76

billion. The Timbercorp group of companies had an ASX-listed parent company and 40 associated entities, in addition to its AFS licensed RE.⁴¹

2.55 Timbercorp's associated entities appointed voluntary administrators on 23 April 2009 after it was unable to meet its financial obligations; operating the schemes and servicing debt.⁴² After the administrators' application to the Victorian Supreme Court to have the olive and almond schemes wound up was opposed by some growers, the application was adjourned to give members an opportunity to explore alternatives. At the time of writing, investors in Timbercorp's olive schemes were considering potential options, including seeking recapitalisation to keep the schemes operating for members.⁴³ Scheme members in Timbercorp's forestry MIS have agreed for timber assets to be sold and the proceeds to be distributed among members and creditors.

2.56 Many growers used borrowed funds to purchase their interest in MIS projects with Timbercorp and Great Southern, which maximised the tax benefits. Both companies provided direct finance to investors, or provided finance in conjunction with another lender. Despite the collapse of these companies, the borrowed money used to invest in their projects is still owed.⁴⁴

Great Southern collapse

2.57 Great Southern Managers Australia Limited (Great Southern) was the RE for 43 registered MIS, including (by size) pulpwood, high value timber, olives, wine grapes and almonds. The schemes had raised around \$2 billion from 43,000 investors in the past five years. The Great Southern group of companies had an ASX-listed parent company and 36 associated entities, in addition to its AFS licensed RE.⁴⁵

2.58 Three weeks after Timbercorp went into administration, on 16 May 2009 voluntary administrators were appointed to Great Southern after it was also unable to meet its financial commitments. Two days later creditors appointed receivers to take control of the charged assets of Great Southern and 11 of its subsidiary companies. At the time of writing, the receivers had sought additional capital to protect and maintain

41 ASIC, *Submission 58*, pp 50-51

42 ASIC, *Information for Timbercorp growers*, accessed on 20 August 2009 at <http://www.asic.gov.au/asic/asic.nsf/byheadline/Information+for+Timbercorp+growers?openDocument>

43 Nickless, R. 'Timbercorp investors granted a reprieve', *Australian Financial Review*, 21 July, 2009, p. 9

44 ASIC, *Submission 58*, p. 24

45 ASIC, *Submission 58*, pp 51-52

their forestry and horticulture plantations and maximise their value for investors and creditors.⁴⁶

2.59 The circumstances surrounding the collapse of these companies are discussed further in Chapter 3.

46 Great Southern Limited, Explanatory note, 'Application to Supreme Court of Victoria 7 August 2009', accessed on 18 August 2009 at <http://www.great-southern.com.au/Application.aspx>; Wood, L. *Sydney Morning Herald*, 'More funds for Great Southern', 18 August 2009, accessed on 18 August 2009 at <http://business.smh.com.au/business/more-funds-for-great-southern-20090817-enqb.html>

Chapter 3

MIS structural issues

3.1 The inquiry canvassed a number of issues concerning the structure for agribusiness MIS in Australia, all considered against the background of the major collapses of Timbercorp and Great Southern. The committee received evidence on the following matters:

- the incentives for MIS investment and related market distortions;
- the effect of high cost structures and uncertain revenue assumptions on scheme performance;
- the ability of the MIS structure to withstand restricted access to capital and potential measures to prevent RE failure; and
- the arrangements for managing competing interests when an RE collapses.

3.2 Investor-related issues such as advice on agribusiness MIS, disclosure and other protective measures are examined in Chapter 4.

Tax incentive issues

3.3 The committee heard a number of complaints about the potentially market-distorting effects of the tax incentives available to agribusiness MIS investors. It was argued that rather than investment flowing to commercial activities on the basis of profitability, tax incentives had generated an influx of investment to agribusiness MIS that would have been directed elsewhere had they not been available. The effects of this are an inefficient use of capital and an uneven playing field for traditional agricultural enterprises competing for scarce land, water and labour resources.¹

3.4 The committee notes that much of this debate centres on the question of whether the effects of the tax incentives are justified by their policy intent of attracting capital to certain industries and regions otherwise unable to attract investment because of perceived market failure. While this debate is addressed to some extent in the discussion that follows, the committee notes that the matter is a primary focus of another committee inquiry into food production being undertaken by the Senate Select Committee on Agriculture and Related Industries.

3.5 Issues concerning the inefficient use of capital also relate directly to suggestions that MIS investment is being directed to unviable agribusiness projects,

1 Institute of Chartered Accountants in Australia, *Committee Hansard*, 15 July 2009, Canberra, p. 31

discussed further in this chapter at paragraphs 3.33 – 3.59 in the context of scheme performance.

Effect on investment decisions

3.6 From a forestry MIS perspective, tax deductibility was an important component of the 1997 forestry plantation '2020 vision' strategy, aimed at trebling Australia's plantation timber output by 2020 to meet future paper demand.² With declining government participation in the sector, MIS tax incentives have served as a popular vehicle for stimulating private investment. According to ASIC, MIS structures now account for approximately 34 per cent of total plantations in Australia.³ Rewards Group Ltd said that forestry MIS has been 'pivotal' to the success of the 2020 vision strategy.⁴

3.7 A3P and NAFI told the committee that the tax incentive available for forestry MIS is needed to ensure private investment in the industry. They argued that without allowing these deductions, private investment would be difficult to attract due to the 'market failure' associated with the 'unique nature of forestry enterprises'.⁵ Investors would be unprepared to accept the agricultural risk, delayed returns and concentrated income events that create a large tax liability at harvest:

Because most of the income in large income events (commercial thinnings harvests and final clearfall harvest) is taxed at the forest grower's highest marginal tax rate, it can be seen that, subject to the taxpayer's individual circumstances, more income tax is likely to be paid on a plantation forestry enterprise than if the same total amount of income had been received and taxed annually – as with most livestock, cropping and horticultural enterprises.⁶

3.8 Other agribusiness MIS have also been able to attract significant investment from investors obtaining allowable deductions. Rewards Group Ltd told the committee that a number of industries would not exist without the availability of the MIS structure:

Prior to the development of the managed investment scheme structure for agriculture and forestry; an export plantation pulpwood industry, an olive oil industry, an almond industry, a plantation teak industry, a plantation sandalwood industry, a plantation mahogany industry, a red grapefruit industry, a low chill stonefruit industry, a viable export mango industry, a

2 Plantations for Australia: The 2020 Vision is a strategic partnership between the Commonwealth, State and Territory Governments and the plantation timber growing and processing industries.

3 ASIC, *Submission 58*, p. 18

4 Rewards Group Ltd, *Submission 19*, p. 6

5 A3P and NAFI, *Submission 56*, p. 8

6 A3P and NAFI, *Submission 56*, p. 8

consolidated strawberry industry, and a plantation brushwood industry, did not exist.

Since the 1970's rural industries have been starved of investment. The managed investment structure has since then, facilitated the successful injection of new capital into this burgeoning component of the Australian economy.⁷

3.9 Mr Alan Jessup of lawyers Piper Alderman also stated this view. He claimed:

One of the benefits of these types of schemes, contrary to the rhetoric of local farmers who have a vested interest in keeping such schemes out of their area (their complaint being that it forces up land prices so keeping down prices enables them to purchase land at a cheaper cost), is that funds that would not otherwise be available for agricultural production in this country are made available. This creates infrastructure and jobs.⁸

3.10 Mr Eric Walters, a financial adviser, stated that the tax deductibility available to agribusiness MIS investors helps ameliorate the unique risk factors attached to agricultural pursuits.⁹

3.11 Maccacorp Ltd, the RE for a MIS in the macadamia industry, told the committee that the deductibility for MIS investment is consistent with that available to any person incurring business costs, including traditional farmers.¹⁰ Almond Investors Ltd also emphasised this point, although it should be noted that the deductions for MIS investors are larger because of the higher costs associated with that business model.¹¹ Consequently, the potential for allowable deductions to have a distorting effect on investment decisions is also increased. As referred to above, this issue is discussed further at paragraphs 3.40 – 3.48 in the context of scheme performance.

3.12 Investment underpinned by tax deductions has not been welcomed by those who believe it to have had a negative effect on rural industries. Horticulture Australia Council (HAC) told the committee that the horticulture industry welcomed corporate investment, but rejected the need for tax deductibility measures to address a market failure:

...we are unconvinced that there is any requirement for government assistance or incentives to encourage people to invest in horticultural enterprises. We believe they are a good investment in their own right.¹²

7 Rewards Group Ltd, *Submission 19*, p. 1

8 Piper Alderman, *Submission 4*, p. 1

9 Mr Eric Walters, *Submission 39*, p. 44

10 Maccacorp Ltd, *Submission 15*, p. 3

11 Almond Investors Ltd, *Submission 32*, p. 3

12 HAC, *Committee Hansard*, 15 July 2009, Canberra, p. 100

3.13 They argued that investment was not best directed when occurring under these circumstances:

...some of the investment that has been pushed in or pumped in because of that tax deductibility upfront has proved not to be necessarily very good. I think the schemes have to stand up in their own right. What is produced at the end of the day is the issue, not the tax deductibility of the upfront investment.¹³

3.14 Although HAC was unwilling to generalise about a diverse industry, they indicated that the tax breaks may have the following effects:

- creating an oversupply of certain commodities, particularly where access to overseas markets is problematic;
- increasing the cost of scarce resources such as land, water and agricultural labour; and
- transferring capital away from proven industries.¹⁴

3.15 HAC's comments about oversupply and resource allocation are discussed further at paragraphs 3.18 – 3.25. Addressing HAC's last criticism, A3P and NAFI disputed claims that investment in forestry MIS is money diverted from other more profitable agricultural activity:

The retail forestry investment model provides a comparative incentive for investment in regional Australia; in areas that would benefit from investment and associated increased economic activity but would otherwise not attract significant investment at all. Retail forestry investment does not 'crowd out' investment in rural and regional Australia, because without retail forestry, rural and regional Australia would not be able to attract a similar level of investment.¹⁵

3.16 However, the need to create incentives for forestry investment was queried during the inquiry. For example, Mr David Cornish suggested that there is no economic justification for the target of trebling Australia's plantation output, just a strategy to achieve an arbitrary and unnecessary goal. He commented:

...billions of dollars of tax payer money has been wasted to support a policy that has never been substantiated as being of net benefit to Australia.¹⁶

3.17 Mr Cornish also discounted the assertion that agricultural enterprises need MIS to attract capital:

13 HAC, *Committee Hansard*, 15 July 2009, Canberra, p. 100

14 HAC, *Submission 17*, p. 6; HAC, *Committee Hansard*, 15 July 2009, Canberra, p. 100

15 A3P and NAFI, *Submission 56*, p. 43

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

The greatest myth that is continually thrown up to support these schemes is that agriculture needs more capital. Nothing could be further from the truth. The capital market for Australian agriculture is as strong as any industry in Australia. This can be easily identified by the fact that capital assets such as land and water are highly overpriced given their earning capacity. The last thing Australia agriculture needs is increased demand for these scarce resources thereby driving the prices up further. The only place where there is a lack of capital is in the industries that cannot provide an economic return.¹⁷

Resource allocation

3.18 Resource allocation was a major concern raised during the inquiry, particularly for traditional farming enterprises. A number of submitters expressed the view that traditional farming enterprises struggled to compete for agricultural resources against tax deductible MIS. Mr Rod Davies, a soil scientist, emphasised the scale of some MIS and their resource use, comparing them with mining projects:

...Timbercorp are only one of the companies undertaking these schemes but ... their schemes, their olive and almond schemes, total 16,000 hectares and Timbercorp claim these developments are worth around \$250 million. These schemes are developed around the Murray and are dependent on irrigation, with water requirements of approximately 160,000 megalitres.¹⁸

3.19 The National Farmers Federation (NFF) expressed concern about the effect of MIS capital access distorting emerging water markets:

The capacity for the schemes to manipulate a developing market is likely to significantly undermine the Governments' intended policy outcomes for the water trading market. There are also a range of considerations relating to the physical limitations of river systems to deliver the required increased water demand, including a move from the fringe irrigation periods (i.e. autumn and spring) to a concentration to the summer period (and particularly the peak period of January).¹⁹

3.20 Sunraysia Irrigators Council claimed that Timbercorp had pushed up the price of temporary water considerably, causing 'financial distress for many genuine irrigators along the Murray'.²⁰ They added:

To show good faith, any large scale horticultural development should be required to purchase the full amount water required before the development can take place. Timbercorp has been able to plant many thousands of hectares of almonds, knowing that it would never be able to buy sufficient water to enable the projects to reach maturity. If these projects are allowed

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

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

19 NFF, *Submission 22*, p. 4

20 Sunraysia Irrigators Council, *Submission 33*, p. 6

to proceed, they will be in the market for water, either permanent high security water, or temporary water, year by year. The schemes will be competing with the Federal Government if they buy permanent water, and other irrigators if they buy temporary water.²¹

3.21 A number of submissions to the inquiry also stated that land prices were being artificially inflated by the tax driven capital flowing into MIS, to the detriment of more traditional enterprises.²² For instance, the Institute of Chartered Accountants in Australia (the Institute) stated:

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.²³

3.22 The Institute of Foresters of Australia (IFA) described the following mixed effects:

MIS companies often do not have sufficient land under ownership or lease when they publish their PDS. Therefore, if the PDS is fully subscribed there is a rush to secure the necessary land to establish the area of plantations bought by the investors. This has led to the choice of buying marginal properties at inflated prices or very high lease payments. There have been positive and negative effects in rural Australia. High demand for marginal cropping or grazing land has allowed some farmers to exit their land at a good price and “retire with dignity”.

In other instances the purchase of land by MIS companies at higher than expected market prices has restricted ability of local farmers to compete and thereby expand their own farming enterprises.²⁴

3.23 A3P and NAFI responded to land price concerns by claiming that many factors had contributed to land price rises:

Rising values of rural land have been driven by a combination of factors that include low interest rates, high commodity prices, strong international demand for Australian farm products, rationalisation in the rural sector with

21 Sunraysia Irrigators Council, *Submission 33*, pp 7-8

22 See for example Kelly Ag Services, *Submission 1*, p. 5; NFF, *Submission 22*, p. 4; Australian Sugar Milling Council, *Submission 27*, p. 5; VFF, *Submission 28*, p. 5, NSWFF, *Submission 52*, p. 8

23 Institute of Chartered Accountants in Australia, *Submission 36*, p. 2

24 IFA, *Submission 42*, pp 10-11

farm amalgamations, competition for farms from overseas buyer, and multiple changes in land use.

Plantations are only one of several competing land uses putting upward pressure on rural land prices in recent years. Plantation companies buying properties have been welcomed by retiring farmers, many having had their properties on the market for some years.²⁵

Oversupply

3.24 The disruption to local industries caused by MIS generating oversupply was also raised with the committee, a matter which is also discussed later in the context of scheme performance and revenue assumptions at paragraphs 3.49 – 3.59. The Victorian Farmers Federation argued that traditional growers are more exposed to the consequences of oversupply:

One of the most significant impacts for the farming community that non-forestry MIS have on commodity markets is that of oversupply. Non-forestry MIS have the capacity to dramatically increase production of the commodities they manage...

Any increase in supply when it is driven by tax purposes rather than market fundamentals, has the potential to lead to oversupply impacting on the returns of not only MIS investors but other operators who have established business without the same tax advantages. This would be financially devastating for farmers, but as investors in MIS are likely to have these types of investments as a part of a port folio and have other incomes streams as their main source of funds they are not impacted to the same degree as traditional farm investors.²⁶

3.25 In particular, there was strong criticism of MIS driving increased wine grape plantings during a period of oversupply. Wine Grape Growers Australia (WGGA) informed the committee that a doubling of Australia's vineyard areas since 1995 had created a chronic oversupply requiring 'an adjustment in vineyard area of as much as 20 per cent to bring supply and demand back into balance'.²⁷ The consequence has been that many growers are receiving prices from wineries below the cost of production, a situation unlikely to improve in the medium to long term without structural adjustment.²⁸ While WGGA indicated that most MIS vineyard operators had ceased new plantings, they noted that further projects are proposed and remain possible. There is a perception among growers of wineries encouraging MIS growth to reduce their own costs, knowing that such investment is not entirely profit driven.²⁹

25 A3P and NAFI, *Submission 56*, p. 41

26 VFF, *Submission 28*, p. 5

27 WGGA, *Submission 44*, p. 1

28 WGGA, *Submission 44*, p. 2

29 WGGA, *Submission 44*, p. 3

Suggested reform

3.26 The Institute suggested a loss quarantining mechanism to limit the distortionary effects of the present deductibility arrangements. They proposed that up-front deductions for agribusiness MIS investment only be permitted to be offset against future taxable income from the same MIS.³⁰ CPA Australia did not support this suggestion, though. They indicated that it would threaten the viability of the forestry industry, as investors would not be prepared to wait until income from harvest before being allowed to claim deductions.³¹

3.27 Mr Kerin Smart proposed that tax deductions only be allowed to the extent of the real commercial cost of running the relevant project.³²

3.28 Maccacorp Ltd recommended that non-forestry MIS be confined to export-oriented or import replacement crops, which would alleviate the problem of MIS producing a domestic glut to the detriment of local producers.³³ WGGGA recommended a moratorium on further ATO product rulings until agribusiness MIS until the current parliamentary and government reviews of the sector are completed.³⁴ Failing this, they called for the removal of tax deductions for investment in vineyard MIS.³⁵

3.29 The Australian Sugar Milling Council called for a restriction on plantation forestry being established on prime agricultural land, subject to an assessment of its broader effects on the local community. Using a Tasmanian example, their submission notes that this is a planning matter under state legislation.³⁶ Canegrowers Australia made a similar proposal:

...a full review of the economic, environmental and social impacts of diversion of significant areas of agricultural land into forestry be required before access is available to taxation concessions for the proposed activity.³⁷

3.30 The Victorian Farmers Federation queried the need for tax incentives for non-forestry MIS entirely:

The original purpose of MIS was to enhance regional wealth creation by increasing plantation resources. As almost 50 per cent of MIS is now

30 Institute of Chartered Accountants in Australia, *Submission 36*, p. 5

31 CPA Australia, *Committee Hansard*, 15 July 2009, Canberra, p. 34

32 Mr Kerin Smart, *Submission 60*, p. 2

33 Maccacorp Ltd, *Submission 15*, p. 11

34 WGGGA, *Submission 44*, p. 5

35 WGGGA, *Submission 44*, p. 6

36 Australian Sugar Milling Council, *Submission 27*, pp 5-6

37 Canegrowers Australia, *Submission 23*, p. 3

accounted for by non-forestry projects, it is time to question whether this indirect form of support continues to effectively deliver targeted assistance to an area of perceived market failure.³⁸

3.31 Delegate Station Pastoral Company advocated the UK model, where forestry planting and establishment costs are subsidised and tax advantages given to value adding processing.³⁹

3.32 The committee makes comment on these proposals later in the chapter (paragraph 3.122 onwards).

Scheme performance

3.33 An important issue the committee has considered is the performance of particular schemes and the effect this has on the viability of the Responsible Entities behind them. From the alternative perspective, the committee examines any effect of the RE structure on the viability of the schemes in the later part of this chapter, beginning at paragraph 3.60.

3.34 A3P and NAFI told the committee that it is necessary to distinguish between individual agribusiness schemes and the companies that manage them as part of a broader commercial enterprise:

We might look at an individual forestry project and say: ‘Yep, that looks like a pretty good project. It’s being grown on appropriate land, it uses appropriate species, there’s a good growth rate, it’s near the port, it’s near the processing facility. That’s a good project.’ It may or may not make a return at whatever rate, depending on how much was paid to establish it et cetera. But some of the companies have a much broader range of factors affecting their profitability. For example, Timbercorp and Great Southern were involved in a number of projects—not just in forestry. They were involved in a whole range of horticultural projects. Of course their job was really managing the projects and marketing the projects, not necessarily the fundamentals of any one particular forestry project.⁴⁰

3.35 This view was supported by IFA:

Those IFA members with knowledge of the two companies under administration have advised that in their opinion the collapses are a result of a wide range of factors more attributed to those companies’ management structures, debt levels and earlier decisions to diversify away from forestry and into other agricultural enterprises. These factors were common to those

38 VFF, *Submission 28*, p. 6. The committee notes that while the proportion of non-forestry MIS projects is nearly 50 per cent, as a proportion of total investment that figure is less (see paragraph 2.51).

39 Delegate Station Pastoral Company, *Submission 50*, p. 9

40 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, pp 67-68; AAG, *Submission 43*, p. 5

entities now in voluntary administration or liquidation. The yield information from respective plantations and standard of forest practice has not had a direct impact on the collapse of these companies. IFA recognises that the plantations have generally been established using standard industry practices and that a large and valuable wood resource has been created by the companies that have recently collapsed. There are many other companies operating forestry MIS schemes which are operating successfully and continue to attract investment funds.⁴¹

3.36 Forestry consultant Mr David Wettenhall also suggested that poor management was the problem, not the nature of the enterprise itself:

I do not believe that the crops are the problem. There are many private growers who are growing forests profitably. But a major part of the problem is that the revenues do not justify the expenses involved in some—but not all—of the managed investments schemes. The excessive costs seem to be overspending on some forestry expenses and administration and marketing expenses, resulting in poor returns to the investors.⁴²

3.37 There were also a number of comments cautioning against premature judgment of the industry generally. Rewards Group Ltd suggested that the industry was not mature enough to make a judgment about the overall performance of the schemes, while Mr Eric Walters, a financial adviser, stated that some early schemes had performed well.⁴³ IFA told the committee that 'most early [forestry] schemes did not achieve projected growth rates, but in most cases the stumpages paid to investors exceeded projected stumpage rates'.⁴⁴ They also noted that 'normal market fluctuations' would significantly affect performance.⁴⁵

3.38 However, other contributors claimed that many of the schemes are inherently unprofitable, having been established on the basis of inefficiently directed capital, high costs, flawed assumptions and a lack of scientific rigour. According to the NFF, this is reflected in poor performance in the overall MIS sector, measured by the discrepancy between 'realistic or actual rates of return versus projected rates'.⁴⁶

3.39 Delegate Station Pastoral Company also refuted the distinction between the corporate entities and the schemes:

At present grower investors of failed MIS companies think they are ok because their products (trees, almonds, etc) are remain in the ground. It seems that many of these grower investors still don't get it. The notion that

41 IFA, *Submission 42*, p. 9

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

43 Rewards Group Ltd, *Submission 19*, p. 6; Mr Eric Walters, *Submission 33*, p. 10

44 IFA, *Submission 42*, p. 7

45 IFA, *Submission 42*, p. 7

46 NFF, *Submission 22*, pp 4-5

once a new responsible entity takes over, all the schemes will return a profit is incorrect. These investors can't change the fact that they have paid far too much to invest in forestry and agricultural schemes where solid markets may not exist.⁴⁷

Cost issues

3.40 There was particular concern that the high cost nature of agribusiness MIS is unprofitable, despite the preparedness of investors to finance them for perceived tax benefits. The Institute's submission to the inquiry suggested that rational investment criteria could be discarded in favour of short term tax benefits, although 'tax attributes should never serve as a sole or primary driver of investment decision-making'.⁴⁸

3.41 The NFF also expressed concern about the basis for MIS investment:

...decisions to invest in MIS are largely based on the tax deductibility of the investment, rather than driven by long-term profitability. As a result, MIS have traditionally been primarily focused on industries with a high proportion of up-front expenses, with little regard given to the output returns generated.⁴⁹

3.42 Macadamia nut producers Maccacorp Ltd argued that the non-forestry MIS structure benefited from economies of scale, even though regulatory compliance costs are higher than traditional, smaller enterprises:

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.⁵⁰

3.43 The committee received evidence describing a forestry MIS business model that cost investors considerably more than other business structures to grow forestry plantations. A3P and NAFI informed the committee the cost of establishing a forestry plantation is around \$1500 per hectare, to engage a professional forester would cost \$5000 per hectare and the cost of investing in a forestry MIS project ranges between \$6000-9000 per hectare.⁵¹ Despite this variance, they argued that some of the

47 Delegate Station Pastoral Company, *Submission 50*, p. 8

48 Institute of Chartered Accountants in Australia, *Submission 36*, p. 4

49 NFF, *Submission 22*, p. 3; see also NSWFF, *Submission 52*, pp 5-6

50 Maccacorp Ltd, *Submission 15*, p. 8

51 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 80

additional cost of forestry MIS is offset by the bargaining power pooled schemes can use when negotiating processing contracts. They also commented that research houses had assessed there to be a return for investors at those levels.⁵²

3.44 Dr Judith Ajani described the forestry MIS model as 'a very high cost business draining the public purse'. She claimed:

MIS eucalypt pulpwood growers invest 4.5 times more than non-MIS growers to do the same job of planting and managing trees over the rotation...⁵³

3.45 Delegate Station Pastoral Company highlighted the potential costs of indirect activity:

No genuine business can afford to have the leaks that a MIS has and remain competitive in the world market. With advisers/brokers taking 10%, promoters taking 30-40%, there is not much chance of making a return, when at least half of your money never hits the ground.⁵⁴

3.46 They claimed that the 70 per cent DFE rule is ineffective to prevent this because it can be 'made up some time at the end of the growing period'.⁵⁵

3.47 In the non-forestry MIS sector, WGGA claimed that exorbitant cost structures had driven investment:

WGGA is aware of a number of Vineyard MIS that have charged investors double and sometimes treble the reasonable establishment costs for vineyards in that production zone, even after taking into account the legal and advisory costs of establishing and marketing the MIS. It is apparent that investors have been more attracted to the tax deductions available through payment of such large sums in the initial years of the investment than pursuing alternative direct investments in vineyard developments not structured as MIS at significantly lower establishment costs.⁵⁶

3.48 Sunraysia Irrigators Council raised similar concerns about Timbercorp almond schemes:

It seemed that investors were paying a significant premium to participate in such schemes, especially when the only asset they owned was the crop on the trees. It appeared that the MIS was using investor money as cheap finance to set up these schemes and then run them for a fee for the life of the project (25 years), avoiding the risk of the uncertainty in the crop – the

52 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 81

53 Dr Judith Ajani, *Submission 9*, pp 2-3

54 Delegate Station Pastoral Company, *Submission 50*, p. 4; see also NSWFF, *Submission 52*, p. 5

55 Delegate Station Pastoral Company, *Submission 50*, p. 4

56 WGGA, *Submission 44*, p. 5

investor took all the risk – and then ending up with a significant asset at the conclusion of the project.

The management structure was also convoluted in that Timbercorp were the scheme promoter, Timbercorp Securities were the responsible entity and Select Harvest was the orchard manager. Proceeds from the eventual crop would have to wash down through these layers of management before the investor would see a return.⁵⁷

Revenue assumptions

3.49 Dr Ajani claimed that the inflated costs in the MIS structure are accompanied by similarly inflated predictions about price and yield; risks borne by scheme members:

Yet MIS growers—informed by the projections presented in prospectus documents—expect rates of return ranging between 6.5% to 11.0% (Lonsec Agribusiness Research 2001). On paper, the cost chasm between MIS operations and actual industry standards has been reconciled using highly optimistic assumptions on wood yields and stumpage prices. In the case of wood yields: in the vicinity of 60% higher than industry actuals. In the case of stumpage prices: in the vicinity of between 93% to 820% higher than industry actuals ...⁵⁸

3.50 There were conflicting views on the effect of maturing MIS plantation supply and predicted global demand on woodchip prices. On one hand, Dr Judith Ajani claimed that forestry MIS have 'driven a hardwood chip glut', forcing prices lower in an industry dominated by publicly subsidised native forest product.⁵⁹ She also questioned predicted global shortages of paper and wood products.⁶⁰ A3P and NAFI disagreed with this view, saying that demand for plantation products is reflected in the steady price of woodchips in comparison with falling prices for other commodities.⁶¹

3.51 With regard to non-forestry MIS, Sustainable Agricultural Communities Australia suggested that the establishment of schemes producing a commodity already in oversupply, such as wine grapes, demonstrated that REs are often motivated by the profit they can make from an increasing investor base, rather than from the enterprise itself.⁶² WGGGA highlighted the limited likelihood of new wine grape projects returning a profit in an environment of chronic oversupply and water shortages.⁶³

57 Sunraysia Irrigators Council, *Submission 33*, p. 2

58 Dr Judith Ajani, *Submission 9*, p. 3

59 Dr Judith Ajani, *Submission 9*, p. 4

60 Dr Judith Ajani, *Submission 9*, p. 6

61 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 79

62 Sustainable Agricultural Communities Australia, *Submission 13*, p. 3

63 WGGGA, *Submission 44*, p. 1

3.52 The approach to establishing new schemes to meet investor demand also came under scrutiny. IFA commented that:

MIS companies often do not have sufficient land under ownership or lease when they publish their PDS. Therefore, if the PDS is fully subscribed there is a rush to secure the necessary land to establish the area of plantations bought by the investors.⁶⁴

3.53 Aside from potentially distorting land prices, as discussed above at paragraphs 3.21 – 3.23, there is a risk that inappropriate projects will be established on unsuitable sites by REs trying to sell more MIS product. Mr Davies suggested that underperforming Timbercorp olive and almond groves in Western Victoria are likely due to inappropriate site selection and irrigation design stemming from poor soil surveying.⁶⁵ Referring to yields well below original expectations, he told the committee that required surveying qualifications are insufficient given the magnitude of the projects:

A surveyor who surveyed some of the ground that Timbercorp has developed could have had as little as five days instruction before being accredited to do one of those surveys for an agricultural scheme worth \$250 million—each of these is worth about \$25 million. If a survey is undertaken by a person with five days experience, it is an unreasonable expectation that that soil information will be of a quality suitable enough to make that sort of financial decision.⁶⁶

3.54 While Mr Davies did not directly attribute the underperformance of yield to poor soil assessment, he said that: 'the elements are there for that type of mistake to be made'.⁶⁷

3.55 Dr McKenzie provided the committee with an example of a failed paulownias project near Forbes in Western NSW, where a soil scientist's qualified opinion that the project would fail on the land selected was dispensed with in favour of a more optimistic assessment. The crop failed and the company managing the project went into receivership. He suggested that the involvement of a qualified soil scientist at the early stages may have prevented this failed decision.⁶⁸ Dr McKenzie recommended that commercial soil surveyors be required by law to hold professional accreditation.⁶⁹

64 IFA, *Submission 42*, p. 10

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

66 Mr Rod Davies, *Committee Hansard*, 15 July 2009, Canberra, p. 59

67 Mr Rod Davies, *Committee Hansard*, 15 July 2009, Canberra, p. 59

68 Dr David McKenzie, *Committee Hansard*, 15 July 2009, Canberra, p. 55

69 Dr David McKenzie, *Submission 7*, p. 3; see also Dr Geoff Kew, *Submission 57*, pp. 2-4. Dr Kew agreed with Mr McKenzie's concerns about training but raised a number of criticisms about Mr McKenzie's claims (submission 7) about methodology. This debate is not examined in this report.

3.56 Other evidence to the committee also suggested that some operators 'shop' for expert opinion to confirm the likely success of their proposed project. Mr Davies indicated that this is often related to the requirement to complete a source survey to obtain an irrigation licence. He suggested that requiring surveyors to be part of a professional association would protect them from pressure to produce favourable reports lest another opinion be purchased.⁷⁰ This matter is further discussed in the next chapter at 4.40 – 4.46 in the context of disclosure material for investors.

3.57 From a forestry perspective, Mr Wettenhall suggested that independent foresters be required to report to the RE's compliance committee, an entity 'at arm's length from the success of the project'.⁷¹

3.58 Mr Alan Jessup of lawyers Piper Alderman claimed that the timing of investors' deductions in relation to the provider's return of income had 'encouraged bad agricultural practice' that include planting horticultural crops in June.⁷² Canegrowers Australia noted a similar experience in Queensland:

...one outcome of the perverse incentives available to MIS promoters has been land management practices that appear to have been geared to obtaining a tax advantage rather than good agriculture. For example, in 2007 and 2008, considerable areas were cultivated just before the wet season in the Ingham area, apparently to allow planting before the end of the financial year. As any local farmer would have predicted, when the seasonal monsoon arrived thousands of tonnes of topsoil, that would have been safe under current cane farming systems, were eroded away to form plumes of sediment in local streams and the Great Barrier Reef lagoon. The schemes' land management practices have been described as appalling.

Since the promoting companies passed into administration, this land is now effectively unmanaged. There is no control of noxious weeds on these properties and they can serve as a haven for feral animals, particularly wild pigs. Without maintenance, further soil erosion is inevitable. Cane growers are heartbroken to see this good land go to waste and are concerned that rehabilitation to profitable and appropriate farming enterprises will be costly and difficult.⁷³

3.59 IFA expressed concern that some hardwood plantation schemes are 'using investor funds to conduct broad scale experiments for plantation suitability'; while some tropical forestry schemes were dependent on 'uncertain markets'.⁷⁴ These views are mentioned further in Chapter 4 (at paragraph 4.46) in the context of disclosure issues.

70 Mr Rod Davies, *Committee Hansard*, 15 July 2009, Canberra, p. 61

71 Mr David Wettenhall, *Committee Hansard*, 15 July 2009, Canberra, p. 87

72 Piper Alderman, *Submission 4*, pp 5-6

73 Canegrowers Australia, *Submission 23*, p. 2

74 IFA, *Submission 42*, p. 9

Agribusiness MIS structural issues

3.60 Related to the issue of whether individual schemes are commercially viable is the considerable debate about the REs behind them, and whether the business models they use are inherently flawed. In particular, some witnesses and submitters suggested that the high cost model is driven by the requirement to sell more MIS to maintain the viability of existing schemes and the RE itself.

3.61 The committee heard that a discussion of the circumstances contributing to the recent collapses of Timbercorp and Great Southern is necessary before structural deficiencies of the MIS model can be ascribed. Some contributors concluded that those companies were victims of external factors that have similarly affected other non-MIS enterprises, while others argued that the agribusiness MIS sector has significant problems with REs using a business model that depends on continuing strong sales to be viable.

3.62 Further on, at paragraphs 3.85 – 3.98, the committee examines suggestions for identifying and limiting agribusiness MIS that are not sufficiently well capitalised to sustain their existence without input from new MIS sales.

Contributing events

3.63 Aside from any structural deficiencies that may have existed, the committee heard that failed agribusiness MIS companies faced a number of challenging events in the period before their collapse. These included the credit crisis and economic downturn, drought, superannuation incentives and tax uncertainty following the ATO's revised ruling.

3.64 There was some evidence that the effect of uncertainty about the deductibility of MIS investment was significant. Mr Alan Jessup of lawyers Piper Alderman claimed that it was an unnecessary contributing factor:

...the taking of a position contrary to law had the effect of creating uncertainty leading to a fall off in investment activity. As a result cash flows of existing operators was adversely affected for a period of time which has contributed to the current circumstances.⁷⁵

3.65 A3P and NAFI speculated that the increase in forestry MIS sales in 2007-08 was due to uncertainty about non-forestry MIS.⁷⁶ They added:

The dramatic downturn in woodlot sales in FY2009 ... was not related to the tax treatment of managed plantation investments. But the uncertainty surrounding the tax treatment of non-forestry projects undoubtedly affected that sector.⁷⁷

75 Piper Alderman, *Submission 4*, p. 5; see also Mrs Glen See, *Submission 11*, p. 4

76 A3P and NAFI, *Submission 56*, p. 15

77 A3P and NAFI, *Submission 56*, p. 15

3.66 Others disagreed with this view. For instance, Mr Wettenhall was of the opinion that changes making superannuation a more attractive investment had been a major contributor to declining agribusiness MIS sales.⁷⁸

3.67 Rewards Group Ltd suggested that the ATO's revised ruling 'created high levels of uncertainty' and reduced income flows. However, difficulties in refinancing and raising new equity, along with sub prime investor loans, were also key factors.⁷⁹ Maccacorp Ltd also nominated drought and excessive leverage during a market downturn as critical issues.⁸⁰

3.68 Indeed, a more common view is that the uncertainty relating to allowable deductions was just one of a number of contributing factors. NAFI and A3P told the committee that the ATO's decision, combined with the drought and credit crisis, meant that Timbercorp and Great Southern had been 'caught up in a perfect storm'.⁸¹ They said that the inability of Timbercorp and Great Southern to obtain short-term debt re-financing, in conjunction with declining asset values, is considered to have been a significant factor.⁸²

3.69 AAG highlighted the confluence of problems affecting Timbercorp and Great Southern: rapid expansion and increased debt followed by sustained drought, tax uncertainty and banks reassessing risk in an environment declining asset values. They concluded:

When the companies were unable to sell sufficient assets, the banks moved to protect their interests. The rest is history.⁸³

3.70 McMahon Clarke Legal held the same view:

...the environment in which the collapses have occurred cannot be discounted—significant drought, high debt levels, tightening credit, declining asset values and commodity price falls at a time when companies were endeavouring to restructure their businesses and reduce debt had an undoubted impact on their financial deterioration.⁸⁴

3.71 Rewards Group Ltd denied that the recent collapses demonstrate that there is a 'fundamental problem' with the MIS structure:

78 Mr David Wettenhall, *Submission 35*, p. 1

79 Rewards Group Ltd, *Submission 19*, p. 7

80 Maccacorp Ltd, *Submission 15*, p. 8

81 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 64

82 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 79; A3P and NAFI, *Submission 56*, p. 35

83 AAG, *Submission 43*, p. 6

84 McMahon Clarke Legal, *Submission 24*, pp 2-3

The primary reason for the collapse of these two organisations was debt structuring in the parent company.

Both companies overpaid for assets and granted loans to investors that were non conforming (sub prime). Any company in any sector is doomed to fail using this business acumen. There are thousands of companies around the globe that have ceased to exist in the last 12 months due to similar business models.⁸⁵

3.72 These submitters maintained the view that the collapses were due to 'a combination of events', rather than 'an inherent flaw in the MIS model'.⁸⁶

3.73 However, other evidence the committee received argued that these factors did in fact expose structural deficiencies inherent in the MIS business model. For instance, Trustee Corporations Association defined these events as 'the first serious stress test of the new MIS regime', which demonstrated structural flaws.⁸⁷ Mr David Cornish also argued that the global financial crisis could not be blamed for deeper structural deficiencies:

...the structure of these schemes and the activities they are involved in means that an investor is highly unlikely to ever receive a consummate return for the risk they take even given the tax benefit of the schemes. After a time the investor will wake up to this fact and will no longer invest in the scheme. No new investors means no cash flow for the promoter and so the schemes fail. This is a systemic structural problem and will continue to happen GFC or no GFC.⁸⁸

MIS structural deficiencies

3.74 The potential dependence on new MIS sales for the viability of existing projects and the corporate entity itself was a matter of particular concern through the inquiry. The discussion concentrated on the cash flow of agribusiness MIS, particularly the problems associated with investors paying fees upfront and at harvest, rather than annually. The committee was informed that forestry MIS typically use a model where upfront fees are charged and annual costs deferred until harvest and met out of the RE's own assets. Alternately, non-forestry MIS more commonly use a recurring annual fee model because of regular income from harvests.

3.75 A3P and NAFI informed the committee that investors had shied away from forestry MIS charging annual fees:

The most significant development in the structure of retail forestry investments has been the move away from annual fees to deferred fees, in which the lease fees and the forestry management costs are taken out of

85 Rewards Group Ltd, *Submission 19*, p. 3

86 Willmot Forests Ltd, *Submission 45*, p. 4

87 Trustee Corporations Association, *Submission 25*, p. 2

88 Mr David Cornish, *Submission 54*, p. 3

harvest sale proceeds. Early on in the offering of retail forestry investments, both structures existed and competed. By about 2004 most, but not all, companies had transferred to the single-payment deferred fee model, as financial advisers and potential investors demonstrated a preference for this payment structure.⁸⁹

3.76 McMahon Clarke Legal commented that the deferred fee model suited financial planners 'because they could legitimately advise their clients that it was effectively a "set and forget" investment'.⁹⁰

3.77 Forest Enterprises Australia informed the committee that they had moved from a recurrent fee model to a deferred fee model 'to stay competitive in the financial services market and to keep pace with apparent investor preferences'. However, they preferred the former:

...on a cash flow-basis from a manager's perspective being able to match operational forestry expenditure with recurrent fee income is a much more logical approach. ...

Our view is that deferred fee model is sub-optimal and puts significant pressures on managers who do not have diversified revenue streams.⁹¹

3.78 While acknowledging the commercial drivers for the single up-front payment, Mr Wettenhall suggested that it was unsuitable for forestry MIS:

...the single upfront payment does not reflect the cash flow of forestry and it is therefore somewhat artificial. Forestry is characterised by a large upfront investment and then annual expenses maintaining the plantation. I am uncomfortable with that structure. Back in the 1990s and the early part of this decade, there were schemes ... whereby you put in an upfront payment to cover the establishment of the trees and then annual payments to cover the rent and maintenance of the trees. That reflected much better the cash flow of forestry and avoided the circumstances that we see now, where the cookie jar is empty and there are still some maintenance and rental liabilities to be met.⁹²

3.79 Piper Alderman concurred:

[The] ability to collect fees in advance ... encourages a type of Ponzi scheme where this years fees are being used to pay last year's expenses.⁹³

3.80 The problem for companies that rely on new MIS sales to support existing schemes is that, as a consequence of these sales, new financial obligations accrue.

89 A3P and NAFI, *Submission 56*, p. 16

90 McMahon Clarke Legal, *Submission 24*, p. 5; see also AAG, *Submission 43*, p. 3

91 Forest Enterprises Australia, *Submission 46*, p. 5

92 Mr David Wettenhall, *Committee Hansard*, 15 July 2009, Canberra, p. 88

93 Piper Alderman, *Submission 4*, p. 3

Macquarie Agricultural Funds Management explained that some companies had become caught in a cycle of sales dependency:

...as companies become successful, as they sell more and more product, they need to acquire more assets. They need to buy the land in which to plant the trees, they need to establish the almond orchards or the horticultural assets and they need to buy water. This creates financial obligations on the company to pull together capital assets.⁹⁴

3.81 While well capitalised companies (including those with a self-funded structure where investors purchase the land) can meet their obligations, Macquarie suggested that others were left in a precarious position:

...the companies that have failed have been in neither of those categories and we think that that has caused difficulty because the companies need to always be looking for fresh equity and fresh debt. We have just been through a very buoyant time in debt and equity markets and during this period companies in this sector, and indeed lots of companies, could attract debt and equity. Sadly, as the debt and equity markets dried up, the companies' capacity to fund these assets became more and more difficult. The equity markets were the first markets to become problematic. When the debt markets closed down as well, that was when the companies became stressed and unable to continue to operate.⁹⁵

3.82 MacMahon Clarke Legal considered that market forces would steer a return to forestry MIS using recurring fee model schemes, rather than deferring fees until harvest.⁹⁶

3.83 Willmot Forests Ltd acknowledged that 'the business model of these companies relied too heavily on annual future sales revenue', though they suggested that the tax uncertainty, credit and drought were extenuating circumstances.⁹⁷ Statistics ASIC provided to the committee indicated that 'MIS sales formed the primary source of revenues and cash flows' for Great Southern and Timbercorp's businesses.⁹⁸ They described the common practice where investor fees are 'diverted into the general working capital of the parent entity', instead of being quarantined for the purpose of meeting the project's future obligations.⁹⁹

94 Macquarie Agricultural Funds Management, *Committee Hansard*, 15 July 2009, Canberra, pp 92-93

95 Macquarie Agricultural Funds Management, *Committee Hansard*, 15 July 2009, Canberra, p. 93

96 MacMahon Clarke Legal, *Submission 24*, p. 5; see also AAG, *Submission 43*, p. 3

97 Willmot Forests Ltd, *Submission 45*, p. 5

98 Application fees accounted for 76 per cent of Great Southern's revenue and 87 per cent of Timbercorp's revenue in 2008. See ASIC, *Submission 58*, p. 23.

99 ASIC, *Submission 58*, p. 23

3.84 ASIC distinguished between a problematic business model requiring additional sales for a 'substantial part' of their working capital, and an illegal ponzi scheme. ASIC commented that ponzi schemes have no meaningful economic enterprise underpinning the investment, whereas agribusiness MIS investors purchase an interest that entitles them to a share of profit from a specific agricultural project. However, ASIC also made the following comment:

Agribusiness MIS operators have been criticised for adopting business models which rely on receipts from application fees for revenue ... this business model may be unstable if the flow of new MIS sales is interrupted.¹⁰⁰

Investment safety regulation

3.85 A number of submitters recommended that the financial capacity of agribusiness MIS to meet their operational requirements be subject to closer regulation. Prudential regulation is currently limited to entities 'where the systemic risks and the intensity of the financial promises, and hence the risk of market failure, are greatest'.¹⁰¹ These include authorised deposit-taking institutions, insurers and superannuation funds, but not managed investment schemes.

3.86 ASIC told the committee that certain financial requirements are imposed on REs as AFS licensees:

As AFS Licensees, REs are required to meet base level financial requirements set out in RG 166. These require the RE to have:

- (a) positive net assets and be solvent;
- (b) sufficient cash resources to cover 3 months expenses with cover for contingencies; and
- (c) maintained audit compliance.

REs must also maintain minimum net tangible assets of \$5 million unless the RE uses a custodian. If a custodian is used, the RE must maintain 0.5% of assets of the registered schemes it operates with a minimum requirement of \$50,000 and a maximum requirement of \$5 million.¹⁰²

3.87 McMahon Clarke Legal described agribusiness MIS as 'one of the most highly regulated sectors in the Australian managed fund market'.¹⁰³ They added that ASIC could provide further guidance to make the existing regulatory regime more effective:

Whilst the collapses of Timbercorp and Great Southern have been profound and far reaching, this submission cautions against reactive regulation and law reform. It is our view the laws governing agribusiness MIS are already

100 ASIC, *Submission 58*, p. 25

101 ASIC, *Submission 58*, p. 14

102 ASIC, *Submission 58*, pp. 6-7

103 McMahon Clarke Legal, *Submission 24*, p. 2

robust enough. It is compliance with, or enforcement of, those laws which needs to be the focus of attention.

There is an opportunity for ASIC to revisit its regulatory guides, or issue new guidance, on minimum requirements it expects to be observed by responsible entities in scheme establishment, promotion and operation in order to comply with those laws. There is also no doubt it is also incumbent on the industry to ensure and promote the highest level of compliance with the laws as they stand.¹⁰⁴

3.88 Commenting on the distinction between ASIC's oversight role and APRA's responsibility for prudentially regulation, ASIC noted:

There is probably an issue emerging as to whether on the setting in relation to that, when you look at some of the failures that have occurred in recent times, there needs to be some discussion. The committee might want to think about whether the prudential requirement settings are currently set correctly.¹⁰⁵

3.89 Macquarie Agricultural Funds Management recommended that MIS providers should be required to demonstrate to ASIC that they are sufficiently capitalised to meet the financial commitments that flow from new and existing MIS sales. They wrote:

This may be achieved by making the annual certification to the regulator as a condition of the [AFSL]. Providers should be required to certify that all future financial obligations of intended (new) and existing agricultural schemes have been appropriately considered and provisioned for, and that in meeting these financial obligations they are not wholly reliant on future or expected income that will be derived from additional agricultural MIS sales.¹⁰⁶

3.90 To prevent potentially unprofitable schemes being established, WGGA recommended that schemes using a high cost model, benchmarked as such against real commercial costs, be prevented from obtaining an ATO product ruling in the first place.¹⁰⁷ Mr Kerin Smart agreed, suggesting that the ATO has been in error by issuing a product ruling for these schemes:

In my view, most of the losses incurred over the last 8-9 years would not have happened if ASIC had enforced Section 1013E and the ATO had

104 McMahan Clarke Legal, *Submission 24*, p. 10

105 ASIC, *Committee Hansard*, 15 July 2009, Canberra, p. 109

106 Macquarie Agricultural Funds Management, *Submission 48*, p. 8

107 WGGA, *Submission 44*, p. 6

restricted deductions in the Product Rulings issued to the real commercial cost of the projects involved.¹⁰⁸

3.91 Maccacorp Ltd suggested that annual management fees be tied to scheme profit to combat the potential agency problem of RE directors benefiting from selling more, rather than profitable, schemes.¹⁰⁹

3.92 Trustee Corporations Association argued that the RE minimum net tangible assets and insurance requirement of \$5 million (each) is too low given the amount of investor funds under management. They also recommended that the compliance committee be removed and providing the compliance plan auditor with a greater oversight role.¹¹⁰

3.93 Forestry consultant Mr David Wettenhall said that upfront payments 'should be set aside for future management expenses', with the funding levels to be held based on the assessment of an independent forester.¹¹¹ Piper Alderman recommended that fees paid for the provision of services over three months in advance be held on trust by a custodian.¹¹²

3.94 AAG was of the opinion that the market may dictate a shift towards this type of practice:

Without legislation, it is possible that market forces could see changes to best practice scheme documentation for the handling of grower funds. Money could be set aside for future management operations and lease obligations in separate trust accounts. The active participation of the Compliance Committee could be used to periodically review the adequacy of account balances against forecast expenses for the life of the schemes. As Compliance Committees are already in place under existing ASIC licensing requirements for all Responsible Entities, they could be used to sign off on when funds can be released following the achievement of set milestones (e.g. planting of trees).

As long as grower funds are held separate to company assets and remained the sole property of an individual scheme, in any event of corporate insolvency this would allow for a much easier replacement/transition of the Responsible Entity.¹¹³

108 Mr Kerin Smart, *Submission 60*, p. 3. Section 1013E of the Corporations Act relates to the requirement for a PDS to contain information that could reasonably be expected to have a material influence on a decision to invest.

109 Maccacorp Ltd, *Submission 15*, p. 11

110 Trustee Corporations Association, *Submission 25*, pp 3-4

111 Mr David Wettenhall, *Committee Hansard*, 15 July 2009, Canberra, p. 84 and 86

112 Piper Alderman, *Submission 4*, p. 3

113 AAG, *Submission 43*, p. 3

3.95 McMahaon Clarke Legal disputed the need to mandate that funds raised for a particular scheme should be held as working capital for that project alone:

In the case of group companies, funds paid as application money or ongoing fees may have been released into the consolidated revenue of the corporate group and then ‘drip fed’ back to the responsible entity and its related parties (which were often subcontractors for a scheme) as and when required. From a legal perspective, it is our view a responsible entity is perfectly entitled to use fees paid to it as it sees fit—once fees are paid and properly applied under the management agreements, the fees become the responsible entity’s asset. This is not to say the responsible entity’s contractual and fiduciary obligations are limited in any way whatsoever.¹¹⁴

3.96 TFS Corporations Ltd also rejected this proposal:

...due to the long duration of the agricultural projects performed by the MIS schemes it would be an inefficient allocation of capital to contribute to reserves for all future expenses. For this reason annual expenses ought to be commercially realistic and the MIS parent company needs to ensure it has sufficient funding to meet its future obligations where the annual fees are deferred.¹¹⁵

3.97 They contended that the efficient operation of the market should drive prudent business practices:

...nothing in the MIS business model prevents the efficient operation of the market and that unsustainable MIS businesses will and should fail. It is expected that there may be further corporate failures in the MIS industry as investor funds and capital is allocated away to more appropriate investments.¹¹⁶

3.98 The committee comments on these suggestions below at paragraph 3.132.

RE collapse

3.99 The committee also received evidence about the problems associated with managing competing interests following the collapse of an RE. Of particular concern was the conflict of interest for insolvency practitioners and protecting growers' interest in the land. The committee also discussed the options available for growers in the failed Timbercorp and Great Southern schemes.

Potential RE conflicts

3.100 One issue of concern is the conflict between an insolvency practitioner's obligation to act in the interest of scheme members and any competing obligation to

114 McMahaon Clarke Legal, *Submission 24*, pp 3-4

115 TFS Corporations Ltd, *Submission 30*, p. 8

116 TFS Corporations Ltd, *Submission 30*, p. 10

creditors and shareholders. ASIC indicated that RE directors may face certain conflicts of interest in discharging their duties, including:

- a personal interest in a related entity such as the landholder or operational service provider;
- the inherent conflict between their duty under section 181 of the Corporations Act to act in the best interests of the corporate entity, and their section 601FD duty to act in the best interests of scheme members (the latter must take precedence); and
- conflicts where a director holds common directorships between the RE and related entities.¹¹⁷

3.101 In the event of the RE for an agribusiness MIS going into administration, ASIC explained that the insolvency practitioner (administrator, receiver or liquidator) is considered to be an officer of the RE under the Corporations Act and therefore subject to the same duties.¹¹⁸ That is, they must place the interests of scheme members ahead of the corporate entity, including creditors.

3.102 Where the RE is insolvent, external administrators have to manage the competing claims of two groups:

1. secured creditors, who may want projects terminated and the land over which they have security sold; and
2. investors, who want the projects to continue to be managed and harvested.

3.103 While an administrator, receiver or liquidator is bound to act in the best interests of members (growers), ASIC acknowledged the concerns about this arrangement:

...in practice, particularly for receivers and liquidators, difficulties may arise in managing the tension between their obligations to growers and their obligations to the RE's creditors. In recent failures in the sector, it is apparent that (whatever the legal position) the fact that there is no person in there charged solely with representing their interests has undermined growers' confidence in the capacity of the existing insolvency laws to protect their position.¹¹⁹

3.104 There has been significant controversy over the role of the RE as an appointed insolvency practitioner following the collapse of Timbercorp. A group of investors in Timbercorp's olive and almond growing schemes opposed KordaMentha's application

117 ASIC, *Submission 58*, pp 27-28

118 ASIC, *Submission 58*, p. 29

119 ASIC, *Submission 58*, p. 29

to have the schemes wound up and the proceeds distributed, seeking to have temporary REs appointed to the schemes to reassess their continuing viability on behalf of growers. At the time of writing, the winding up application has been adjourned to allow growers to vote on the options before them.¹²⁰

3.105 Lawyers Piper Alderman observed that the current arrangements are unsuitable:

Clearly a responsible entity should not continue to be a responsible entity if it is externally administered. This is because of the inherent conflict of interest of an administrator or liquidator which has to act in the interests of creditors when there is an overriding duty to also act in the best interests of members.¹²¹

3.106 They recommended the following amendment be made to the Corporations Act:

If a responsible entity of a registered scheme becomes externally administered under Chapter 5.3A or a liquidator is appointed to the responsible entity then ASIC must apply to the Court for the appointment of a temporary responsible entity by the Court pursuant to section 601FP of the Corporations Act 2001.¹²²

3.107 This proposal was supported by McMahon Clarke Legal:

...the interests of investors are best preserved and enhanced by having a temporary responsible entity with experience and expertise in running agribusiness MIS being appointed as soon as possible.¹²³

3.108 To overcome the problem of potential temporary REs being unable to operate that particular scheme under their licence conditions, Piper Alderman included the following recommendation:

Notwithstanding the aforesaid provisions, an entity which holds an Australian financial services licence which authorises it to operate a managed investment scheme of any kind may be appointed by the Court ... as a temporary responsible entity.¹²⁴

3.109 According to Piper Alderman, the current provisions of the Corporations Act providing that ASIC 'may' apply to the Court for the appointment of a temporary RE

120 Nickless, R. 'Timbercorp investors granted a reprieve', *Australian Financial Review*, 21 July, 2009, p. 9

121 Piper Alderman, *Submission 4*, pp 3-4; see also Australian Forest Growers, *Submission 53*, p. 2; and FPA, *Submission 40*, p. 5

122 Piper Alderman, *Submission 4*, p. 4

123 McMahon Clarke Legal, *Submission 24*, p. 6

124 Piper Alderman, *Submission 4*, p. 4

had led to ASIC being 'particularly inactive in acting to protect members'.¹²⁵ Mr Michael Butler also criticised ASIC for being 'reluctant' to appoint a temporary RE. He claimed that the current insolvency practitioner for Timbercorp has inflated the price required to harvest the 2009 crop to benefit the RE, rather than growers.¹²⁶

3.110 A3P and NAFI also called on ASIC to facilitate the appointment of a separate RE to 'overcome this inherent conflict of interest'.¹²⁷

Protecting investors' land interests

3.111 In light of potential ambiguity about members' interests following the collapse of the RE, some submitters highlighted the importance of investors maintaining a right to access the land projects use for the life of that project. There was particular concern about the potential for leases to be terminated and land to be sold free from the lease encumbrance if rent is not paid on time, due to the RE's financial difficulties.¹²⁸ ASIC indicated that growers' ownership rights are 'not always clear as a matter of law' when schemes are wound up.¹²⁹

3.112 IFA suggested that scheme offers should only be made where access for the life of the project is assured:

...it is problematic that MIS investors are vulnerable in situations whereby their investment (eg in trees) is jeopardized if the security over the owner or lender associated with the land upon which the trees are grown does not match the duration of the MIS investment. MIS companies should only be able to offer schemes, where they can clearly demonstrate they have guaranteed access to the land upon which the trees are to be planted for the entire duration of the scheme.¹³⁰

3.113 Mr Alan Jessup of lawyers Piper Alderman recommended an amendment to the Corporations Act to prevent liquidators selling the land in conflict with the interests of growers. Specifically, he suggested that the land be held by a custodian on trust for the growers, and that this arrangement only be terminated where the court determines it is just and equitable to do so.¹³¹ This proposal was supported by McMahon Clarke Legal and A3P and NAFI.¹³²

125 Piper Alderman, *Submission 4*, p. 5

126 Mr Michael Butler, *Submission 14*, p. 2

127 A3P and NAFI, *Submission 56*, p. 45

128 See for example A3P and NAFI, *Submission 56*, p. 45 and McMahon Clark Legal, *Submission 24*, p. 6

129 ASIC, *Submission 58*, p. 25

130 IFA, *Submission 42*, pp 9-10

131 Piper Alderman, *Submission 4*, p. 2

132 McMahon Clark Legal, *Submission 24*, p. 6; A3P and NAFI, *Submission 56*, p. 45

3.114 Macquarie Agricultural Funds Management recommended that sale and leaseback arrangements be subject to the pre-existing rights of investors.¹³³ Macquarie also suggested that the best way to protect investors' rights in the land is to require the provider to have sufficient funds set aside to meet land costs for the life of the project, or be adequately capitalised to buy the land outright.¹³⁴

3.115 McMahon Clarke Legal proposed that disclosure be improved (see also paragraphs 4.28 – 4.53):

...greater disclosure on land and water rights is required, including details about ownership, whether those assets are encumbered, the risks associated with the form of ownership and the encumbrances and other related matters.¹³⁵

Post collapse scheme management

3.116 The collapse of an RE necessitates the appointment of temporary REs to continue running the schemes on behalf of growers, generally under circumstances where they are considered profitable despite any requirement to recapitalise them. If such an entity (or entities) cannot be found, the schemes are wound up and proceeds from the sale of the assets are distributed amongst growers.¹³⁶

3.117 A3P and NAFI expressed the view that forestry plantations established under Great Southern and Timbercorp would derive returns:

...we are confident that in some way the vast majority of these trees will continue to be managed. We do not know exactly how that is going to unfold, but there are companies who are looking at the opportunities in relation to that resource. There is a significant resource there—as you say, hundreds of thousands of hectares with trees growing on it. What we have to get to is who will ultimately own that [and] how they will go about harvesting it...¹³⁷

3.118 They added: 'we hope that, whatever happens, it happens quickly'.¹³⁸ The committee notes that Timbercorp forestry MIS growers have since agreed for the schemes' assets to be sold.

133 Macquarie Agricultural Funds Management, *Committee Hansard*, 15 July 2009, Canberra, pp 94-95

134 Macquarie Agricultural Funds Management, *Submission 48*, p. 9

135 McMahon Clark Legal, *Submission 24*, p. 5. This is further discussed in Chapter 4.

136 Where growers obtained finance to make their investment, the payments owing could exceed the returns from the winding up.

137 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 77

138 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, p. 78

3.119 When queried about the likely returns to investors in the event of the forestry plantations being sold, A3P and NAFI indicated that it may exceed the \$1500 per hectare cost of establishing them:

It depends very much on the state of the individual plantation resource you are talking about. If these are trees that are about to be harvested next week, they will obviously be of a much higher value than trees planted last year. So the timber value has to be taken into account. In some cases that might be very small, if it is a tiny area of plantation way out in Woop Woop and the trees have not been growing well. If it is a fantastic plantation very close to other areas that are currently being harvested, it will have a much higher value. So there is a huge range, and it is very difficult for us to generalise.¹³⁹

3.120 AAG suggested that the upfront fee model could make finding a replacement RE difficult:

The upfront model has inherent difficulties in the event of corporate parent insolvency where a replacement Responsible Entity is effectively being asked to manage the schemes until harvest without any income. This can present a significant road block in the appointment of a new responsible entity.¹⁴⁰

3.121 Mr David Wettenhall told the committee that, in the short term, the collapses had disrupted the cash flows of many contractors and caused 'particular financial hardship'.¹⁴¹

Committee view

Tax deductibility

3.122 The committee is concerned about the potential for the tax deductibility for non-forestry agribusiness MIS to unfairly distort capital markets to the detriment of other rural enterprises. However, the committee considers that, on balance, the tax deduction for non-forestry MIS under the general business deductions rule is not unreasonable where there is a clear focus on scheme profitability, rather than exploiting tax breaks. The deductibility arrangements for MIS investment are consistent with that available to any person incurring business costs, now that the courts have determined that such investment is a business expense. However, there is currently potential for MIS to use unprofitable high cost structures to provide greater tax deductibility to investors, while directing a proportion of this tax-related investment to related entities charging above commercial rates for project services. Where investor focus is on minimising tax, rather than investing in the most profitable

139 A3P and NAFI, *Committee Hansard*, 15 July 2009, Canberra, pp 80-81

140 AAG, *Submission 43*, p. 3

141 Mr David Wettenhall, *Committee Hansard*, 15 July 2009, Canberra, p. 85

venture, this directs capital away from profitable uses and disadvantages traditional farming enterprises by increasing natural resource costs and encouraging oversupply.

3.123 The committee notes that the collapse of Timbercorp and Great Southern has undoubtedly focussed investors' attention on the importance of investing in commercially viable MIS. Such sentiment should temper the distortions evident when tax incentives cloud judgment about the viability of some projects. The committee also believes that the Institute's suggestion, where deductions for MIS investment are only permitted to be offset against future taxable income from the same MIS, has some merit in addressing the worst distortions caused by the current arrangements. The committee therefore recommends that the government consider this condition on deductibility for non-forestry agribusiness MIS claimed under the general business deduction provisions of section 8-1 of the ITAA 1997.

Recommendation 1

3.124 That the government considers investigating and modelling the effects of amending the ITAA 1997 to ensure that tax deductions for non-forestry agribusiness MIS investment under the general business deduction provisions of the ITAA 1997 only be permitted to be offset against future taxable income from the same MIS.

3.125 There are more pressing arguments for tax deductibility for investment in forestry MIS as provided for under Division 394 of the ITAA. The committee understands that the long lead time and one-off character of forestry income events discourage investment in the industry. Although the committee recognises that there is a vigorous debate over whether the goal of trebling Australia's plantation output by 2020 has a sound economic basis, the inherent disincentives to invest in forestry warrant the retention of the existing arrangements. The committee notes that the recent failures of Timbercorp and Great Southern will focus future investors' attention on MIS profitability, negating the worst effects of indiscriminate capital investment.

3.126 The committee also recognises that there are concerns about the likely effectiveness of the 70 per cent DFE rule to ensure that forestry MIS do not adopt uncompetitive business models with significant expenditure being directed outside forestry. However, the new arrangements are relatively new and should be given the opportunity to work. The committee is of the view that the government should continue to monitor the effectiveness of Division 394's integrity measures closely against industry practice and amend them if required.

MIS structural issues

3.127 The committee heard legitimate concerns that high cost MIS business models, encouraged by tax deductibility, cannot generate profit for investors and necessitate inflated revenue assumptions to attract investment to projects. There were also a number of witnesses and submitters who contended that the Responsible Entities operating the schemes are inherently of questionable viability when placed under stress. While it is not possible to generalise across the entire agribusiness MIS sector,

the MIS model does potentially encourage Responsible Entities to develop business models with a ponzi-like character if external factors such as access to credit and drought intervene, necessitating extra MIS sales to inject working capital into existing schemes. Cash flow problems associated with external events have been exacerbated by up-front fee models deemed necessary to sell forestry MIS in the market. These deficiencies have been exposed by the collapse of Timbercorp and Great Southern.

3.128 A number of factors could work to mitigate these concerns. Firstly, the committee again notes that the market will undoubtedly be more careful about agribusiness MIS projects for some time, especially schemes that cost significantly more per hectare for investors than the commercial cost of the activity. Secondly, the integrity measures included in the Division 394 arrangements for forestry MIS should be given an opportunity to work, in particular the 70 per cent direct forestry requirement designed to prevent excessive capital being siphoned off in management fees and administration. Fourthly, the market's preference for up-front payment schedules may be revised following the recent business failures, and investors are likely to increasingly demand that their funds be held solely for the purpose of operating the scheme for which they were raised.

3.129 Despite this, there is still a strong argument for some sort of prudential oversight of agribusiness MIS schemes to help prevent failures of the sort seen most recently. MIS providers should be required to demonstrate that they have sufficient working capital to meet the financial commitments they incur from existing schemes and new MIS sales, without being dependent on further, additional new sales for their viability. As this issue is relevant to product safety issues explored in the committee's report on financial products and services, the committee will reserve any recommended legislative changes until then.

Post-collapse issues

3.130 The committee acknowledges that the Corporations Act clearly states that insolvency practitioners, as officers of the RE, are required to act in the best interests of members. However, committee members are concerned about the way conflicting obligations to members and the corporate entity and its related entities are managed in practice, which generates an understandable lack of trust in the current arrangements amongst growers. The committee therefore recommends that the government amend the Corporations Act to require ASIC to appoint a temporary Responsible Entity when a registered managed investment scheme becomes externally administered or a liquidator is appointed.

Recommendation 2

3.131 That the government amend the Corporations Act to require ASIC to appoint a temporary Responsible Entity when a registered managed investment scheme becomes externally administered or a liquidator is appointed.

3.132 Finally, the committee is of the opinion that the problem of land interests after a collapse is best addressed by ensuring that schemes are adequately capitalised to

meet their land cost obligations for the life of the project in the first place. Land owners are entitled to terminate lease arrangements when rent is not paid. However, there are obvious conflicts of interest when the land is owned by a related entity. In this regard, the committee has concluded that the proposal for land to be held by a custodian on trust for the growers is worthy of consideration. The committee anticipates that the market may dictate a shift in this direction, rather than regulation being necessary in this area.

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. WGGGA 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 WGGGA, *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

Appendix 1

Submissions received by the committee

- 1** Kelly Ag Services
- 2** Neil Smithson
- 3** John Rasic
- 4** Piper Alderman
- 5** Dr Simon Evans
- 6** Gerry Vaughan
- 7** Dr David McKenzie
- 8** Roderick Davies
- 9** Dr Judith Ajani
- 10** Martin Kerrigan
- 11** Glen Slee
- 12** Name Withheld
- 13** Robert Belcher
- 14** Michael Butler
- 15** Don Ross
- 16** Alfred Cass
- 17** Horticulture Australia Council
- 18** Australian Taxation Office
- 19** Rewards Group Ltd
- 20** Paul O'Connor
- 21** Dr Mark Burton
- 22** National Farmers' Federation
- 23** CANEGROWERS
- 24** McMahon Clarke Legal
- 26** CPA Australia Ltd
- 27** Australian Sugar Milling Council
- 28** Victorian Farmers Federation
- 29** Phil Davies
- 30** TFS Corporation Ltd

- 31 Confidential
- 32 Almond Investors Limited
- 33 Sunraysia Irrigators Council
- 34 Gavin Butcher
- 35 Plantall Forestry Consultants
- 36 The Institute of Chartered Accountants in Australia
- 37 Name Withheld
Supplementary Submission (Confidential)
- 38 Name Withheld
- 39 Eric Walters
- 40 Financial Planning Association of Australia Limited
Supplementary Submission
- 41 Name Withheld
- 42 Institute of Foresters of Australia
- 43 Australian Agribusiness Group
- 44 Wine Grape Growers' Australia
- 45 Willmott Forests Limited
- 46 Forest Enterprises Australia Ltd
- 47 Juliet Low
- 48 Macquarie Agricultural Funds Management
- 49 Confidential
- 50 John and Will Jeffreys
- 51 Gunns Plantations Ltd
- 52 NSW Farmers' Association
- 53 Australian Forest Growers
- 54 David Cornish
- 55 Dean Evans
- 56 NAFI and A3P
- 57 Dr Geoff Kew
- 58 Australian Securities and Investments Commission
- 59 Gary Jackson
- 60 Kerin Smart

Tabled documents

Memo from David McKenzie to Pat Hulme dated 13 July 2009 regarding Paulownias at Forbes, tabled by David McKenzie on 15 July 2009

Statement to the committee, tabled by NAFI and A3P on 15 July 2009

Additional information

'Code of conduct for commercial soil surveyors: An introduction to the code and guidelines', dated 22 March 2004 and provided by Mr Rod Davies

Appendix 2

Witnesses who gave evidence at the public hearing

Canberra, 15 July 2009

ATO

Mr Bruce Quigley, Second Commissioner of Taxation

Ms Stephanie Martin, Deputy Commissioner of Taxation

Mr Des Maloney, Deputy Chief Tax Counsel

Treasury

Mr Paul McCullough, Acting Executive Director, Revenue Group.

Mr Geoff Miller, General Manager, Corporations and Financial Services Division

ICAA

Mr Hugh Elvy, Head of Financial Planning and Superannuation

Mr Jonathan Forrest, Member

CPA Australia

Mr Paul Drum, General Manager Policy and Research

Financial Planning Association

Ms Jo-Anne Bloch, CEO

Mr David Haintz, Director

Mr Rod Davies (Private capacity)

Dr David McKenzie (Private capacity)

A3P and NAFI

Mr Alan Cummine, Manager Plantation Investment, A3P

Mr Alan Hansard, CEO National Association of Forest Industries

Mr Richard Stanton, CEO Australian Plantation Products and Paper Industry Council

Plantall Forestry Consultants

Mr David Wettenhall

Macquarie Agricultural Funds Management

Mr Anthony Abraham, CEO

Horticulture Australia

Mr Stuart Swaddling, Chair

Ms Kris Newton, CEO

ASIC

Mr Tony D'Aloisio, Chairman

Mr Greg Medcraft, Commissioner

Dr Pamela Hanrahan, Senior Executive Leader - Investment Managers

Answers to Questions on Notice

1. ASIC

ASIC 1 – Hansard p. 112

CHAIR—Have you had any concerns in the past where there have been directors who have actually resigned from either the responsible entities or the boards because they had concerns that there was no independence, that they were not meeting their obligations and they found no other mechanism to deal with those issues bar resigning? Have you heard of or read of or are you aware of something like that?

Mr D’Aloisio—We would need to check that. Certainly none come to my mind. I could ask my team to look at that and give you a more specific answer.

CHAIR—I am referring specifically to the two that have collapsed, Great Southern and Timbercorp.

ASIC 2 – Hansard pp. 112-113

Senator BOYCE—Regarding section I, where you mentioned the promotional material and what you have done, particularly in relation to PBSs, I was having some difficulty working out ‘and then what happens?’, looking for instance at 115(c), (d) and (e). Does ASIC attribute motive to these failures?

Mr D’Aloisio—What would typically happen is that if, for example, there was a misleading statement in something we would clearly speak to the entity first and assess that. Let us assume we concluded that it was misleading. Then, either the entity itself would correct it then and there without a stop order or alternatively we would issue a stop order and it would be corrected and then the stop order would cease to apply. We would need to look at the specific cases, but generally these are ways of getting things fixed so that fundraising and so on can continue on a better and informed basis.

Senator BOYCE—What I am not picking up there is whether we are talking about entities or organisations with a history of needing to be ‘picked up’, so to speak, or whether we are talking about quite isolated incidents.

Mr D’Aloisio—It would depend. We can look at those numbers in more detail for you and give you a more specific answer and look at the five matters and the three matters that are listed there.

Answer ASIC 1 – Hansard p. 112

ASIC records do not indicate that, prior to the appointment of external administrators, any directors of Great Southern or Timbercorp raised concerns with us over independence issues where they found no other mechanism to deal with those issues bar resigning.

We are aware of media articles suggesting 2 directors former directors of Great Southern Managers Australia Limited had resigned due to concerns over conflicts of interests (and other issues) they were concerned about.

For example, we note the following media articles which raise these concerns:

- How timber chief cashed in his chips, Australian Financial Review, Angus Grigg and Cameron Rhodes, 10 June 2009; and
- Auditors mislead in Great Southern scandal, Australian Financial Review, Angus Grigg and Andrew Burrell, 2 July 2009.

Answer: ASIC 2 – Hansard pp. 112-113

When ASIC conducts a surveillance activity, the issues and outcomes of those activities are recorded in databases which is relied upon by compliance staff and management to identify future work that may be necessary to continue to improve the relevant sector that that entity is in. For example, through analysis of our databases we may be able to ascertain that a particular group of financial service providers is over-represented in terms of the work we do. That over-representation may lead us to develop specific compliance programmes to address the on-going issues we are seeing. An example of this was a series of concerns raised in the mortgage funds sector led ASIC, in September 2008, to require operators of mortgage funds to provide enhanced disclosure when selling their products.

In terms of the 67 surveillance activities we have conducted over the past 3 years in the agribusiness MIS market, the distribution of entities is as follows:

- We conducted one surveillance on 31 entities;
- We conducted two surveillances on 12 entities (24 surveillance activities); and
- We conducted three surveillances on 4 entities (12 surveillance activities).

The information above suggests there was a degree of repetition with some entities in the agribusiness MIS sector, however a majority of actives were isolated. Where we have conducted more than one surveillance on an entity, it is more a case that we conducted ongoing monitoring of that entity following an initial concern being acted upon. For example, on several occasions because we had identified disclosure issuers with an agribusiness MIS PDS in one year, we conducted a review of that

entity's PDS in the following year automatically. That second review generated a separate surveillance activity.

2. ATO

Topic: How many MIS product rulings has the ATO produced?

Hansard Page: CFS 13-14

Question:

Mr ROBERT—How many MIS product rulings has the ATO produced?

Ms Martin—In the last year—

Mr ROBERT—No, since you started product ruling.

Ms Martin—I do not have the total figure. I can get it for you.

Mr ROBERT—Can you also, when you come back on notice, tell us for each of the product rulings how long it took between when the product ruling was requested and when the ATO actually publicly released it. If there have been 20 product rulings, how long was it from request to when it was released? You might want to provide some comment, for example there might have been some back and forwarding between the person who requested it and therefore the delay might have been caused by the requestor.

Mr Quigley—Is that for each product ruling?

Mr ROBERT—For each MIS product ruling.

Answer:

(a) How many MIS Product Rulings has the ATO produced?

As explained in the ATO's submission to the Committee, product rulings were introduced by the ATO in 1998 to provide certainty about the taxation consequences of participating in a particular scheme. The ATO has issued 1,351 product rulings from 23 September 1998 to 30 June 2009, of which 1,055 were in relation to the agribusiness industry, across the following categories:

Category	Product Rulings
Horticulture	546
Forestry	509
Film	56
Finance	132
Non Commercial Losses	108
Total	1,351

There are several factors that need to be considered when comparing the number of product rulings issued by the ATO with the number of managed investment scheme (MIS) arrangements offered in the market place. For example:

1. The relevant provisions in the *Corporations Act 2001* relating to product disclosure statements for managed investment schemes require a statement about the taxation consequences of the relevant arrangement. However, this does not require that this statement be based upon a Product Ruling, although many entities do apply for a product ruling to meet this requirement.
2. Prior to 2002 participants entered into schemes through a prospectus which had a 13 month life. The *Corporations Act 2001* was amended by the *Financial Services Reform Act 2001* which introduced product disclosure statements from 11 March 2002 that have an unlimited life. MIS managers then designed schemes that accepted participants in more than one year and provided for a variety of classes of participant. The ATO then commenced issuing product rulings for each year and for each class of participant covered by the product disclosure statement. Since 1 July 2003 the ATO has published 526 product rulings for 279 agribusiness (forestry and horticulture) MIS; and
3. To deal with previously issued product ruling arrangements covered by the non-commercial loss provisions applying from 1 July 2000, the Tax Office issued a number of product rulings in 2002 and 2003. These product rulings exercised the Commissioner's discretion to not defer losses for MIS participants where there was an objective expectation that the scheme would produce taxable income within a period that was commercially viable for the industry concerned.

(b) How long does it take the ATO to consider and issue a product ruling after an application is received?

In the 2009 financial year;

1. 65 per cent of product rulings, being 30 of the 46 that issued, were considered and issued within 90 days from when sufficient information was provided for the Tax Office to consider; and

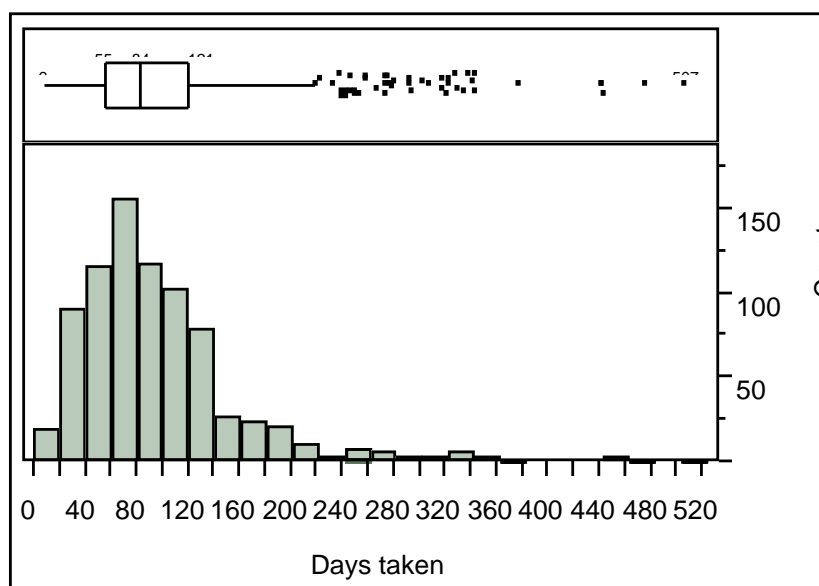
2. on average 24 per cent of the product ruling case time was in relation to the ATO waiting for further information from the applicant.

The average time for the year ended 30 June 2009 from when sufficient information for the Tax Office to consider an agribusiness MIS application and a ruling being issued was 73 days. Approximately one week of this timeframe is taken for the publication and gazettal process for each product ruling.

The following graph shows the distribution of time taken to issue all agribusiness product rulings during the period 23 September 1998 to 30 June 2009 from the date they came into the office with sufficient information for the ATO to proceed with the application. The information does not include finance, film or non commercial loss product rulings.

Distribution of time taken (days) to issue Agribusiness product rulings.

The diagram below provides the length of time taken to issue each of the agribusiness related product rulings.



Delays in the issue of Product Rulings may be caused by a number of factors, including;

1. the submission of additional or updated material by the applicant. Applicants sometimes make changes to the draft product disclosure document and supporting agreements during the application process, such as to offer finance to the growers or change the contractual arrangements;
2. applicants taking a significant period of time to respond to ATO requests for additional clarifying information. This may also lead to the applicant making subsequent changes to the arrangement, the underlying agreements or fee structure; and

3. the presence of complex technical issues that may not have a precedent and which require detailed analysis by the ATO.

Topic: Cost to the tax system of managed investment schemes

Hansard Page: CFS 19-20

Question:

CHAIR—Unless you have got this data at hand, you can take this question on notice. Can you get back to the committee with a percentage or a number as to the return to the tax system from MI schemes in comparison to the deductions, the cost to the tax system, of MI schemes.

Ms Martin—I am not sure we will have that data. It is only under the forestry measures that we can identify the actual deductions claimed. That is only in relation to the new forestry measures in division 394. Similarly, when the income is returned it is not always singled out separately. So I will check, but I suspect that we will not be able to give you that specific answer.

CHAIR—Could you not only check but also have a look at the system in terms of making that determination. I am not making a judgment on the tax treatment, I am just making the point that there is a cost to the tax system and, therefore, the taxpayer in these schemes. And there would be an expectation of a return in the future through the growth, viability and returns that are expected of these schemes and the tax that is paid by the RE. I would like any information, any data, any quantification of that ratio and any other information around that. I am particularly interested in how that might work. I would like to see either historical data or data on your expectations for the future.

Answer:

A check of ATO systems confirms that there is no basis upon which to determine the amount of deductions claimed by participants in agribusiness managed investment schemes (MIS), or the income flows resulting from such investments. This is because deductions claimed for expenditure in MIS and income derived from these schemes are recorded in income tax returns as part of the normal business activities of the participant taxpayers (who are each running their own small business according to the case law) and cannot be segregated from other non-MIS small businesses.

Topic: Discretion in relation to ‘long tail arrangements’

Hansard Page: CFS 20-21

Question:

Mr Maloney—There is another discretion in relation to what I will call ‘long-tail arrangements’—for example, a hardwood forestry plantation. If you make an investment now, it is going to be many years before that investment returns assessable income, so the income test will not be satisfied. But where the

commissioner thinks it is reasonable that, because of the particular kind of arrangement that has been entered into, there will be income in the future, but it does not satisfy the test this year, he can exercise a discretion as well.

Mr Quigley—I think we have given a ruling on that.

Mr Maloney—We have got a ruling.

CHAIR—Can those provisions be abused in any particular way by the scheme itself or by the RE? Is there a way for that to be manipulated? I am particularly interested in two things. Again, maybe you can take it on notice and come back to us. One is whether it is either used or abused by the RE or the scheme managers in any particular way to create losses. The other might be whether the scheme is ever commercially viable. If that is not the case then the non-loss provisions become part of the scheme itself rather than in the event of, as you say, a drought, a flood or some other mitigating circumstances.

Mr Maloney—I think the essence of your question really goes to when is the commissioner satisfied that his discretion ought to be exercised. In relation to agribusinesses, we take advice from industry experts in relation to the expectations that are put to us about income derivation over time.

CHAIR—Maybe you could just take that question on notice about the commercial viability in terms of any losses, with a bit more information about how the ATO actually treats that particular area. That would be helpful.

Mr Maloney—Sure.

Answers:

For agribusiness managed investment schemes (MIS), the Tax Office usually considers the operation of the non-commercial loss provisions in the income tax law as part of its consideration of each application for product ruling made by Responsible Entities (REs). Applicants request the Commissioner to exercise a discretion in the provisions which in effect allows the losses to be claimed from the first year rather than be deferred until net profit is derived in a later year. The Commissioner has the discretion to allow these losses to be claimed if a net profit is objectively expected within a commercially viable period, which is

“... based on evidence from independent sources (where available) that, within a period that is commercially viable for the industry concerned, the activity will ... produce assessable income for an income year greater than the deductions attributable to it for that year ...” (subparagraph 35-55(1)(b)(ii) *Income Tax Assessment Act 1997*)

In considering whether to exercise the discretion, the Tax Office takes into account estimated cashflows over the life of the project provided by the RE and requests reports by industry experts about what would be an appropriate period for such a project for the relevant produce in the particular geographic area (based upon industry expertise and comparison with other businesses producing similar produce). The Tax Office has issued two Taxation Rulings on the operation of the non-commercial business loss regime, including its application in the context of agribusiness MIS (Taxation Rulings TR2001/4 and TR 2007/6).

The Tax Office has identified some instances where the subsequent implementation of the project has failed to achieve a net profit for investors in the year when the exercise of the Commissioner's discretion expires (for example, in year six when the Commissioner has granted a five year period for the discretion). Where this has occurred, the Tax Office has advised the RE and the investors that the subsequent year deductions for the losses will be deferred until the project produces net assessable income.

Other arrangements have also been identified by the Tax Office which involve the potential creation of losses for consolidated groups of entities containing the RE. There may also be related tax risks for investors in either the MIS project or associated land trusts. The Tax Office issued a Taxpayer Alert (TA 2008/11) on such an arrangement on 6 June 2008 and is following up with appropriate compliance action.

3. CPA and ICAA

Question on notice: "What percentage of the accounting profession is either not a member of CPAs or not a member of Chartered Accountants?"

We refer to the question on notice above, and now provide the following joint response on behalf our respective organisations. Determining the size of the accounting industry, the number of individuals who refer to themselves as accountants and the market share of the respective professional accounting bodies – in particular CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) - is not readily determinable as the term ~accountant" is widely used. However, the following provides the Committee with an indication via the current available data.

A. The accounting profession, and Australian members

The Institute and CPA Australia view the accounting profession as comprising those individuals who are appropriately qualified and have been admitted by way of membership of one of the professional accounting organisations. These professional organisations include the Institute and CPA Australia. In this regard, we distinguish the *accounting profession* as the leading component of the broader and larger generic category of *accountants*.

As advised on 15 July 2009, our members work in a diverse range of fields including:

- industry and commerce
- not for profit sector
- public sector (government)
- academia, and
- public practice

The current Australian memberships of the Institute and CPA Australia are as follows:

the Institute of Chartered Accountants in Australia	50,000
CPA Australia	85,000 ²

Also as discussed during the Inquiry on 15 July 2009, while the term accountant is not a regulated term in Australian law, and there are a large numbers of individuals who refer to themselves as accountants this does not mean that accountants are by and large unregulated. For example, accountants are, depending on their field of practice, subject to a wide range of legislative regulation, for example:

- registered company auditors
- registered tax agents
- registered insolvency practitioners

Further, professional members of the InstiMe and CPA Australia are also subject to professional and ethical standards issued by the APES Board as well as their respective organisation's by-laws.

B. Data available regarding numbers of accountants In Australia

There are a number of statistical sources that can provide an indication of the market and market share. For example according to Joboutlook.gov.au³, there were 157,000 accountants in Australia in August 2008. This category only includes: Accountant, Management Accountant and Taxation Accountant.

Conversely, according to the most recent Australian Bureau of Statistics (ABS) data⁴ there are 123,214 people who described themselves as accountants. However ABS also has other similar categories, for example accountants, auditors and corporate treasurers (536), accounting clerks (90,534), auditors (9547), branch

accountants and managers (13,967), company secretaries (974), and corporate treasurers (2029) amongst others. In total these add up to 240,810. We expect that many of these would not call themselves accountants. However many would be viewed generically as accountants in the market.

As can be seen from the data provided above and depending on how it is categorised and interpreted it can result in different outcomes, and therefore it is indicative only.

C. Determining market share

As previously stated determining market share for accountants in Australia between the professional accounting organisations is not readily determinable. For example, the Institute and CPA Australia have members who have membership of both professional bodies. Accordingly adding the total membership of the Institute and CPA Australia would overstate the number of professional accountants and overstate the market share when compared to the ABS data.

Notwithstanding the above comments and observations, membership of the two professional bodies do make up a significant and important segment of the accounting industry.

D. Summary

The data provided above provides an outline of both the number of the Institute and CPA Australia members, and the number of those who as per the ABS data who may consider themselves to be accountants. Based on this data and other data available it is not possible to provide a more definitive answer to the Joint Committee's question.

We trust this information is of use to the Joint Committee, and if the Joint Committee has any further queries please advise.

4. FPA

FPA Submission and evidence concerning Agribusiness Managed Investment Schemes

Further to the FPA's appearance at the PJC Hearing on Wednesday 15 July 2009 and to your message of 23 July, I wish to provide the following additional information arising in response to the Committee's questions to the FPA.

Number of authorised representatives involved in promoting either Great Southern or Timbercorp

Our understanding is that there were 380 individuals identified by ASIC that operated directly as authorised representatives of Great Southern. We have been able to confirm that three (3) were FPA members. In addition, there were Australian Financial Services Licensees who had their own authorised representatives that were

recommending agribusiness MIS. This number is much harder to quantify because of the broad number of AFSLs, and authorised representatives, operating in Australia. We are not sure of the relevant number that were authorised by Timbercorp.

Results of FPA investigations into members' exposure to Great Southern

Mr Robert asked if we would be prepared to provide the results of FPA investigations into the exposure of FPA members that are corporate bodies, known as FPA principal members. This information was contained in the copy of the survey attached to my previous letter dated 20 July and is provided again for convenience as an attachment to this letter.

FPA survey of Principal Members

The FPA conducted a survey of its Principal Members between 21 and 25 April 2009. Details of the survey and results are contained in the attached report.

Complaints concerning Agribusiness financial advice

In the course of the FPA's oral testimony before the committee I was asked about the number of complaints the FPA has received about Agribusiness advice. I wish to inform the Committee that we have in fact received one (1) complaint concerning Agribusiness.

The matter is in the inquiry phase of our Professional Accountability Process. Our initial inquiries indicate whilst the consumer concerned was a financial planning client of our member, he received advice and recommendations to invest in Great Southern investment projects from a different firm of accountants whose principals were authorised representatives of Great Southern Securities Limited. Nevertheless, until the process is complete we treat this as a complaint against the member, and I wish to formally correct the record.

5. Macquarie

Macquarie 1 Hansard p. 97

Mr Abraham-In Macquarie Agricultural Funds Management our independent forester provides us with an annual assessment on what is happening. They review the practices and they report to the board. That is independent of forestry or indeed of us, who manage the business.

Senator BOYCE-So they report straight to the board. Do you publish their reports?

Mr Abraham-We put out a summary of their report. I think we put their report on our website. If you like, I can confirm that for you. We generally make things

like that available to our investors.

Response - Macquarie Agricultural Funds Management

Macquarie engages an expert forester to conduct an annual assessment of the silvicultural performance of each of the Macquarie Forestry Investment plantations. Macquarie provides its investors with a summary of the key findings from the expert forester report in its annual agribusiness newsletter which is sent to investors and made available via the Macquarie agribusiness website. The full copy of the report is used primarily for internal management purposes and is not provided to investors.

In addition, Macquarie engages an expert forester to conduct an annual review to assess the performance of each of its forestry plantation managers in each of the regions in which the Macquarie Forestry Investments operate. Expert foresters are also engaged to provide a quarterly report to the Boards of the Responsible Entities regarding plantation performance and any relevant issues affecting the plantations. This is done on a quarterly basis to ensure the Boards have oversight over the plantation operations. These quarterly board updates are for internal management purposes and are not published to investors.

6. Treasury

Question: Treasury 1

Topic: The '70 per cent rule' for forestry MIS

Senator Boyce asked: Has the 70 per cent total expenditure figure gone now or does it still exist? Why is it 70 per cent?

Answer:

Division 394 of the *Income Tax Assessment Act 1997* provides for investors in forestry managed investment schemes to receive a tax deduction equal to 100 per cent of their contributions, provided that there is a reasonable expectation that at least 70 per cent of the scheme manager's expenditure under the scheme, calculated at arm's length prices, is expenditure attributable to establishing tending and felling trees for harvest (Direct Forestry Expenditure or DFE).

The 70 per cent requirement is designed to ensure that most of the funds contributed by investors are spent on activities directly related to establishing, tending and felling trees for harvesting.

Question: Treasury 2

Topic: Secrecy and disclosure provisions in the tax law

Senator Farrell asked: Is there any need to incorporate new exceptions into the tax laws to allow for greater cooperation in matters that are only of a civil nature?

Answer:

The *Review of Taxation Secrecy and Disclosure Provisions* (the Review) was first announced in August 2006. While its principal goal was to consider the possibility of consolidating, into a single framework, taxation secrecy and disclosure provisions currently found across numerous taxation Acts, it has also considered the need to introduce new disclosure provisions where the public interest in disclosure outweighs the impact on taxpayer privacy.

One such new disclosure is reflected in the exposure draft *Tax Laws Amendment (Confidentiality Taxpayer Information) Bill 2009* (the Bill) released for public consultation in March of this year. Of relevance, the Bill proposes to remove restrictions on the Australian Taxation Office's (ATO) ability to provide taxpayer information to the Australian Securities and Investments Commission (ASIC).

Under the existing taxation law, taxpayer information can be provided to ASIC to enable it to perform its law enforcement function but only where it relates to an indictable offence. Under the proposed new framework, ASIC would be able to obtain taxpayer information to fulfil its broader law enforcement role – that is, in relation to all criminal offences and all provisions that ASIC administers that impose a pecuniary penalty.

In the course of the Review, no concerns have been raised regarding the limitations that taxation secrecy provisions impose on the ability of the ATO to disclose information to the Australian Competition and Consumer Commission. The Bill is currently being revised to take into account the results of public consultation.