COMMONWEALTH OF AUSTRALIA

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Agribusiness managed investment schemes

WEDNESDAY, 15 JULY 2009

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JOINT STATUTORY COMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 15 July 2009

Members: Mr Ripoll *(Chair)*, Senator Mason *(Deputy Chair)*, Senators Boyce, Farrell, McLucas and Williams and Ms Grierson, Ms Owens, Mr Pearce and Mr Robert

(Senator Williams for the duration of the inquiry into financial products and services in Australia)

Members in attendance: Senators Boyce, Farrell, McLucas and Williams and Ms Grierson, Mr Ripoll and Mr Robert

Terms of reference for the inquiry:

To inquire into and report 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.

WITNESSES

Committee met at 8.31 am

CHAIR (Mr Ripoll)—I declare open this public hearing of the Joint Committee on Corporations and Financial Services. Having regard to the recent collapses of Timbercorp and Great Southern the committee is inquiring into aspects of agribusiness managed investment schemes or MISs. Witnesses giving evidence to the committee are protected by parliamentary privilege. Any act which may disadvantage a witness on account of their evidence is a breach of privilege and may be treated by the parliament as a contempt. It is also a contempt to give false and misleading evidence to a committee. The committee prefers to hear evidence in public but we may agree to take evidence confidentially. The committee may still publish confidential evidence at a later date but we would consult the witnesses concerned before doing this.

I welcome the witnesses from the Australian Taxation Office and Treasury to the table. Parliament has resolved that an officer of the Commonwealth shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy. It does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

[8.32 am]

MALONEY, Mr Des, Deputy Chief Tax Counsel, Australian Taxation Office

MARTIN, Ms Stephanie, Deputy Commissioner, Aggressive Tax Planning, Australian Taxation Office

QUIGLEY, Mr Bruce, Second Commissioner of Taxation, Australian Taxation Office

McCULLOUGH, Mr Paul, Acting Executive Director, Revenue Group, Treasury

MILLER, Mr Geoffrey John, General Manager, Corporations and Financial Services Division, Treasury

CHAIR—I invite you to make a brief opening statement.

Mr Quigley—We appreciate the opportunity to assist the committee in its deliberations in this area. The Commissioner of Taxation provided a submission which gave some context to the ATO's responses and responsibilities regarding agribusiness managed investment schemes. I thought I would highlight a few areas that have been fairly topical over some period and in recent times. The first is our approach to product rulings. The ATO's responsibility is in administration and application of the tax laws including, obviously, managed investment schemes.

Product rulings were introduced in 1998 to provide certainty to participants about the tax consequences of investing in those types of schemes. We expressly caution potential participants that the ATO does not sanction or guarantee any product as an investment. Product rulings when they are issued expressly state that no assurance is given as to the commercial viability or the reasonableness of fees, charges by managers or the projected returns that might be on offer. Rulings bind the commissioner with respect to the taxation consequence providing that the arrangements are implemented in accordance with that described in the relevant ruling.

The committee would no doubt be aware that in around 2006 the ATO reconsidered its view on the deductibility of investments in agribusiness arrangements. That was prompted by some developments around that time in both the Corporations Law and the tax law. We reconsidered our view and came to the conclusion that the amounts paid by participants were capital and therefore not deductible. We recognise though that it was not free from doubt and we sought to minimise the impacts on the agribusiness MIS sector by testing the matter through the courts. We included that under our test case funding program.

To minimise the impacts on the sector, in March 2007 the commissioner announced that there would be a transition period, which is nearly 16 months, before the reconsidered view would actually be applied. The reconsidered view was not to apply until 1 July 2008. It was intended that that would give sufficient time for the matter to be tested in the courts and also to recognise that industry needed to bring forward a suitable case and that would take some time.

Because of the protection provided by previously issued product rulings, no investors in agribusiness MISs that were covered by a product ruling at the time and implemented in accordance with that ruling were affected by the reconsidered ATO view or the test case, nor did the reconsidered view have any impact on the issue of product rulings for forestry arrangements. That was because the former government announced in May 2006 arrangements to remove uncertainty surrounding whether MIS investments were deductible under the tax law. After consultation and quite a lot of collaboration with the industry to get a test case to the court, the Federal Court handed down its decision on 19 December last year. The court accepted the industry argument that investment in the MIS arrangement was deductible. On the same day, the commissioner publicly accepted the court's decision and we moved quickly to finalise the five relevant product rulings that we had waiting.

We have seen the latest industry data which indicates that there was no significant reduction in the funds raised by industry since we announced our change of view nor does there appear to be any significant difference in the proportion of the funds raised between forestry and non-forestry schemes over that time. Nevertheless, it appears from that industry data that there are a number of variables that may have impacted on the viability and the level of investment in the industry in recent times. These included extended drought conditions in areas of Australia, contributions into superannuation competing for investor funds and the global financial crisis and credit squeeze.

I might now go to the potential tax consequences of the failure of MIS managers. The failure of the managers in itself is not a reason to disallow deductions previously claimed by participants in affected schemes. Any business may fail and legitimate tax deductions are not disallowed in the event that they do fail. It needs to be appreciated that the participants are running separate businesses to that of the MIS manager. A variety of circumstances need to be considered to identify the tax consequences that may flow from the recent failures of MIS managers. We are preparing a draft taxation ruling that we will be issuing for public comment around what all those tax consequences might be. The timing of the ruling will depend to some extent on the further discussions we have and also the outcomes of the receivership and voluntary administration processes for the MIS managers. The tax consequences will certainly be impacted in regard to the way those particular matters progress.

Finally, the spectre of the ATO clawing back deductions previously allowed to participants has attracted some attention in the media over the last couple of weeks. I can say that the vast majority of participants have nothing to be concerned about in this regard. However, we are working through some issues relating to deductions for the more recent forestry MIS arrangements, and we intend to provide guidance on that issue shortly. We also publish on our website general advice on the tax consequences for participants in these arrangements. Thank you.

CHAIR—I want to explore the test case that you took in terms of the deductibility of expenses. It must have been a fairly torrid time. It was about 18 months between the tax office raising these issues and the change that took place and the court's ruling to go back and change the ruling again. In your submission, you say you are confident that your decision to take that case on did not have a material impact in the sector and you said that there was no significant reduction in investments. Do you have some hard data on any particular changes that relate to that period?

Mr Quigley—As I said, the data I was referring to was the industry data, the AAG 2008 annual report. That is what I was quoting from. It is not our own data.

CHAIR—So you are confident that the ATO's decisions and procedures at that point had no material impact on the viability or success of MIS or the investment that flowed into them.

Mr Quigley—Yes, I do. I think we did everything we possibly could by allowing the transition period and in working with the industry to get a suitable test case to put before the courts. It did take some time because we and the industry had to make sure that it would be a case that would resolve the issue one way or the other. We jointly applied to the Federal Court to have the matter heard by the full Federal Court so that it would be a once-and-for-all matter. As I said, we responded on the day to say, 'We accept the court's decision and we'll move forward.' My colleagues who were closer to it at the time may have something to add.

Ms Martin—I will go through some of the details of how we worked with industry prior to the test case being run. We had discussions with the industry about our concerns through 2006. By the time it was announced that we would be considering the change of view we had also had discussions with industry about how to manage the ongoing issue of product rulings during that period, recognising the timing of when they go to market and raise their funds.

During the 2008 year—that is, between July 2007 and the end of June 2008—we wrote to all players. I think it was in May that we wrote to the MIS managers. We went through a process of anticipating what product rulings and arrangements they would be putting in place. We went through a program to schedule our ability to respond to those requests in a timely way, giving them a lodgement date and a processing time. The announcement at the time it went for testing was that it would have effect either from 1 July 2008 or earlier if the court decision came earlier. So we had to make sure there were not arrangements that might be in progress at that stage.

As we worked through it with industry, the matter had to be tested through a private binding ruling process. Usually matters are tested in an audit process, in which case you are already in dispute; you have already had a change of view. So we had to arrange it through a private binding ruling process. We also had to change a public ruling through the process and go through public consultation. In April 2008 industry were concerned that the decision might not be made by June 2008, and again we agreed to receive and encourage early lodgement of product ruling requests to stockpile them in anticipation of the court decision, which is where both parties agreed to apply to the court for an urgent full Federal Court hearing.

CHAIR—Does that now leave us in a situation where the court's ruling is clear to the industry and the ATO, the matter of deductibility—at least in the sense of what schemes and parts of schemes are deductible—is clear and the tax office is satisfied with that into the future? Is that the situation now as you understand it?

Mr Maloney—Yes. It seems to us that, with regard to the general, run-of-the-mill managed investment scheme cases that are agribusiness cases structured in a particular way, with licence or leasehold interests and management contracts, the courts have said fairly unequivocally that the investors are carrying on a business and that that has certain tax consequences. It makes the contributions on revenue account and therefore deductible.

CHAIR—Can the ATO explain whether, in terms of the tax deductibility, you make a distinction as to how much of the investment money is spent on particular parts of the MIS business? Or is it just a case of: as long as the investment is made in the scheme, regardless of where the money or the investment ends up, it continues to be a full deductibility?

Mr Maloney—No, they are structured in a particular way to ensure that the bulk of the contribution is incurred in relation to management fees and/or lease or licence fees.

CHAIR—So for the ATO there is no further question as to the percentages within the investment? As long as the scheme is structured in the correct manner and meets your eligibility criteria then it is a full 100 per cent deductibility, regardless of what the scheme actually does. It is more a case of: as long as it meets your criteria in terms of your product rulings, it is 100 per cent deductible—is that correct?

Mr Maloney—Unless there were some reason for us to think that the arrangements as put to us would not be carried out in the way that they were put to us, that is right, yes.

Ms Martin—There is also some case law authority that, in the absence of grossly excessive fees, we cannot challenge the deductibility of the fees on the grounds of the components. I think there is a quote to the effect that it is not for the court or the commissioner to say how much a taxpayer ought to spend on obtaining his income. When we issue a product ruling we consider the application of the tax laws in that regard, so it is the application of tax laws.

CHAIR—So, in essence, as long as the scheme meets the criteria then what they actually do with the investment—whether they spend it appropriately or not appropriately—or whatever judgement you might make, in terms of marketing, fees, commissions and promotion, are of no concern to the ATO. Is that the case—that those things are not of concern to the tax office in terms of the deductibility of the investment?

Ms Martin—Yes.

Mr Maloney—From the investor's perspective, they are paying, very clearly and quite strictly, management fees and, as I say, lease fees.

CHAIR—Regardless of the percentage, though?

Mr Maloney—Regardless of the percentage. Well, that is almost all of what they pay—it is very rare for a non-deductible amount to be incurred. The money goes into the scheme. Then it is expended by the responsible entity on behalf of investors in respect of the various things that need to be done.

CHAIR—But is that the point at which the ATO no longer has a jurisdiction, as it were, in terms of what happens?

Mr Maloney—That is right.

CHAIR—So it is a delineation point.

Mr Maloney—The question is: what is the legal nature of the arrangement entered into by the investor, and is the price that they pay for that an allowable deduction? If it is, then from our perspective that is the end of it—provided, of course, that the arrangement is entered into as described.

CHAIR—All right; that clears it up for me in terms of the ATO's role in where the investment goes beyond the deductibility.

I will just ask one more question before I hand over to the rest of the committee. In terms of failed schemes and the failure of managers: there are complex arrangements in place between so-called owner-growers, investors, managers, the responsible entity, the land ownership tenure and a whole range of other very complex structures within different schemes. When a scheme fails, how does the ATO treat future deductibility if there are continued expenses or other claims made in terms of trying to maintain either a scheme or something else, depending on the level of failure? Really what I am asking you is: how do you manage that? Let us deal with that and then I will come back to the claw-back.

Mr Maloney—It will depend on what the extra—I will call it an extra—contribution that is asked of the investor is. It will depend on what that is for. If it is for ongoing maintenance of the, let us say, crop, then there would be no change in the nature of the investor's interest. They would still have an interest in the scheme. They would be still, as the courts have told us, carrying on a business.

CHAIR—Even if that is a failed scheme that has collapsed, and depending on receivership, and so on?

Mr Maloney—That is right: it would depend on what the extra contribution were for. But, assuming a new manager were to come in and try to keep the process going, then it seems to us that that deduction or that contribution would also be deductible. It would just be continuing—it might be on behalf of maintenance or something else.

CHAIR—So unless the scheme is completely broken up, sold off and whatever else, deductibility is maintained as long as somebody is in control of the scheme and some payments are made—

Mr Maloney—Yes, and the scheme is continuing on in much the same way as it was intended.

CHAIR—Including while it is in voluntary administration, receivership or—

Mr Maloney—Presumably the project is still being managed and is still being undertaken.

CHAIR—Is that regardless of its legal status? For people who either have paid continuing fees or will pay continuing fees, is there some sort of legal entity issue for deductibility?

Ms Martin—There are two different issues here: the scheme that the investors have contributed to versus the responsible entity that is in administration or liquidation. Even though the manager may go into administration, the scheme may continue in accordance with a product

ruling, in which case nothing has changed and payments are made and deductions are as they were previously. It may continue, it may get sold to a different responsible entity or it may continue in a different way, in which cases the deductibility will depend on the application of laws to the new arrangement as it continues. The third option is that the collapse of the responsible entity may lead to the winding up of the scheme itself, in which case it no longer exists and obviously any payments having to be made by investors or any receipts received will need to be considered according to tax law as to their nature.

CHAIR—That leads me to the clawback that you mentioned earlier. What is the intention of the ATO in terms of that point in time where it may change ownership or the scheme completely fails? If it fails, say, halfway through the tax year or at some other point where somebody has already paid the fees or invested and made the claim, would you say the claim no longer stands because the scheme no longer stands? Can you explain exactly how that process works?

Mr Maloney—It depends if it is a afforestation arrangement or another kind of agribusiness managed investment scheme. So there are two different outcomes depending on the nature of the arrangement. There are specific provisions dealing with forestry arrangements and there is a clawback, for want of a better word, where a CGT event happens within four years of the investment. The deduction is taken not to be allowable and the proceeds of the sale of the interest are included in assessable income. Those provisions were designed to facilitate secondary trading—

CHAIR—Have you had any capital gains tax issues with any schemes? Is there any history of them?

Mr Maloney—Not as such.

CHAIR—I did not think so. Please continue.

Mr Maloney—Those so-called clawback provisions were designed to facilitate secondary trading so that, if you went into an arrangement, paid your initial application fee and sold out within four years, the deduction would be taken away from you, the proceeds of sale would be included in your assessable income and the purchaser would, in a sense, stand in your shoes in relation to the investment.

CHAIR—I understand why that provision was initially put in, in terms of making them tradeable commodities and creating a secondary market, but what happens in the event of a complete failure when it was not the decision of the investor to divest themselves of that initial investment?

Mr Quigley—These are the issues we need to really work through. I think it is fair to say that the legislature did not seem to contemplate this sort of a failure. So what we have to do is work through the law that we have at present and apply the facts to it. As Mr Maloney indicated, it is pretty clear that the provisions around the four-year rule were intended for secondary market arrangements. We just need to work through and see how the present situation stacks up with the law that we have.

CHAIR—I accept that. What I am asking you, though, is: in the case where the investment is not sold onto a secondary market or otherwise dealt with in terms of the legislation, where the investment no longer exists due to a failure, is there some clarity about how that would apply? Does the ATO have a view as to how that would apply in that situation?

Mr Quigley—It is probably fair to say that we do not have a definitive view at this point. We are certainly working to get advice out prior to any completion of administration and the like, so we will give guidance to investors. It is fair to say we are working through that.

CHAIR—What is your time frame? When will you make a decision on that particular issue?

Mr Quigley—As I mentioned, it is dependent on the time frame and the processes for the administration of the MIS managers. We will be working on a time frame to get advice out prior to the finalisation so that people know exactly where they stand.

CHAIR—You will have advice out there? You will be able to provide people some certainty as to their investment?

Mr Quigley—Yes.

Senator BOYCE—Are you in direct contact with investors in these schemes or are they relying on their advisers for your information?

Ms Martin—We do have phone numbers people can call. We also have some general advice on our website that we keep up to date.

Senator BOYCE—Sorry, Ms Martin, I missed the first sentence. You said—

Ms Martin—We do have contact numbers that investors can call us on. We would generally refer them to the information on our website. On the website we try to keep a range of topical questions of issues of concern to them where we can give some general advice.

Senator BOYCE—Would you expect that ruling to go up on that website and be publicised?

Ms Martin—Yes, when we have a view, as well as any formal ruling process as well. As soon as we have a view on that issue, yes, that would be the case.

Senator BOYCE—Of course some of these people are quite distressed.

Ms Martin—Yes.

Senator BOYCE—I want to sort out initially the differing tax treatments of forestry MISs, agribusiness MISs and other MISs.

Mr Quigley—Mr Maloney is probably best placed to provide that.

Mr Maloney—Where would you like to start? Which ones?

Senator BOYCE—Can you just give me—

Mr Maloney—They are different.

Senator BOYCE—That is right, and we are all aware of the differences in forestry. But can you perhaps talk me from bottom to top.

Mr Maloney—I will do my best. Let us just think about a non-forestry MIS. If you enter into an arrangement prior to the end of the income year in a sense you prepay, or on other occasions it might be intended that what you are paying for is to be done within that income year. If it is all done within that income year, you will get a deduction for what you pay. If it is to be done over a period of time, that deduction is spread over what is called the eligible service period. It is still deductible, but the timing has changed. In relation to what we will call tax shelters, that has been the case since 1999. The arrangements were changed for afforestation managed investment schemes in 2001. What we call the 13-month rule was reinstated and so, provided the thing to be done was—

Senator BOYCE—So you can just bring forward your deductions.

Mr Maloney—That is right, yes, provided that the thing to be done under the arrangement was done within 13 months. Of course then there is the new 394 specific deduction that came in from 1 July 2007. That is entirely different from the normal deduction provision. It has its own code, and if you satisfy the provisions there you get a deduction for the contribution made—no spreading.

Senator BOYCE—Outside the broad forestry area, other agribusiness MISs are treated like all other MISs.

Mr Maloney—Yes.

Senator BOYCE—So we have just a two-tier system not a three-tier system.

Mr Maloney—That is right, yes.

Senator BOYCE—Has the 70 per cent total expenditure figure gone now or does it still exist?

Mr Maloney—No. That is in the 394 arrangements.

Senator BOYCE—Why is it 70 per cent?

Mr Maloney—Nice question.

Senator BOYCE—The answer is possibly ‘why not’, but who would have decided 70 per cent?

Mr Quigley—That is what is actually in the law.

Senator BOYCE—Okay.

Mr McCullough—I am sorry; I was not anticipating questions about this law because it was enacted about a year or two ago. I can take on notice the question of why 70 per cent. I would not want to try to guess right now.

Senator BOYCE—It is really about trying to see what it relates to and therefore its effect. Is there a history that warrants it?

Mr Maloney—The broad idea behind it was to ensure that the contributions were actually being spent on what I will call forestry management—planting, tending—making sure that the forest is a goer.

Senator BOYCE—Exactly. There are some real trees out there somewhere.

Mr Maloney—Yes; that is right. It is in contradistinction to the notion that the manager can charge whatever the market will bear, some of which will be directly on forestry expenditure and the balance might well be profit.

CHAIR—Just following on from what Senator Boyce is asking, but in relation to my earlier question on this, the ATO has no link or authority otherwise on whether it is 70 per cent that is spent particularly on product, on the actual business rather than—

Mr Maloney—Yes. It has to be 70 per cent. It has to be demonstrated that the intention is—

CHAIR—But I have asked that question before about 100 per cent of the deductibility. The question earlier was, 'Do you require a percentage of that spent on any—

Mr Maloney—I see what you mean. Yes.

CHAIR—I thought that was clear because you gave me an answer which said, clearly, yes.

Mr Maloney—No. The 394 arrangements require that 70 per cent of the fees are to be spent on direct forestry expenditure. If that turns out not to be the case, the conditions that give rise to the deduction are not satisfied and they may be clawed back.

CHAIR—Does the ATO actually pursue that?

Mr Maloney—Indeed, yes.

CHAIR—Because it appears that a number of schemes spent significantly less than that on the actual forestry business itself. We have reports and documents and there would be annual reports that would show that it is closer probably to 50 per cent.

Mr Maloney—Are these arrangements that are intended to satisfy division 394, or are they intended just to be the normal what we call 8-1 deduction arrangements?

CHAIR—No. It was my understanding that they were provisions designed to satisfy 394.

Mr Maloney—The requirement is that 70 per cent gets spent on direct forestry expenditure.

CHAIR—That is the requirement. Back to my earlier question: what link, what authority or what work does the ATO do to ensure that that is the case?

Mr Maloney—We do what I will call product ruling reviews whereby we examine the arrangements that have been entered into. People come to us and say, 'This is what we are going to do.' It is designed, obviously, to satisfy the requirements of the law, including the 70 per cent expenditure test. We take at face value what has been put to us.

CHAIR—Did you require any evidence or proof? That was my question before. What is your link or authority? Do you require evidence or proof?

Mr Maloney—It is put to us that that is what they are going to do, and that is what the contractual arrangements—

CHAIR—It is basically on their word. It is on the scheme's word that they—

Mr Quigley—The law is predicated on an expectation that 70 per cent would be spent on this forestry type arrangement.

Ms Martin—The law requires 70 per cent to be tested at the time that the arrangement is put into place—it is reasonably expected to be spent on direct forestry expenditure. We go through that process, which includes some independent advice about supporting that. The test is at the time, though we do obviously review arrangements. We always have a look at what actually happens on the ground and then feed that back. It is either a compliance issue, in which case we would take action. If it is feedback as to whether the policy is working, that is feedback we would provide to the policy perspectives. I think also there is a review period for a division 394 after a period of time. It has only been in place for a short period of time. One of the things we are quite conscious about seeing, as with all legislative arrangements, is if they actually achieve the policy intent. That is something we do look at. I just caution that it is very early in the stage for that particular division. We have very few.

Mr Maloney—Mr Chairman, just for your benefit: section 394.35 controls, if you like, this part of the arrangement. It says:

(1) A * forestry managed investment scheme satisfies the ***70% DFE rule***—

the direct forestry expenditure rule—

on 30 June in an income year if it is reasonable to expect on that 30 June that the amount of DFE under the scheme … is no less than 70% of the amount of the payments …

So it is a criterion that needs to be examined at the time that the arrangements are entered into. We make a decision based on what we understand to be a reasonable expectation that the contracts that are being entered into will be honoured.

Senator BOYCE—I have a question on a different area of the submission that the ATO put in, where you talk about the product ruling and test case that you ran. You say:

We kept Treasury informed about what we were seeing on the ground.

Could you please explain what you mean by that comment.

Ms Martin—We engage with Treasury regularly and we let them know what we are seeing in the product ruling applications, the sort of information we receive.

Senator BOYCE—Are you telling them the level of applications you are receiving or what?

Ms Martin—We would tell them the level of applications and the types of applications we are seeing. We would also let them know, for example, that what led to some of the test cases was some concern about some of the other court decisions, increasing unease about the state of the certainty of the law at that time but also what was happening in the industry.

Senator BOYCE—What would trigger you to say, 'This is something we probably should tell Treasury about'?

Ms Martin—We have very regular and ongoing—

Senator BOYCE—Yes, but there must be some criteria that you would use to decide, 'This is a piece of information that should be passed on to Treasury.'

Ms Martin—Generally that would either be if we saw a compliance issue—but that would be an issue for us to deal with as a compliance issue and we would let them know—or if we saw an issue that we thought was activities that were not a compliance issue but they might be interested in reviewing the policy side of it.

Senator BOYCE—So, where you think there might need to be a change to the law, you would be telling them?

Ms Martin—If we thought that was the case or if we had concern that what was happening was not matching the policy intent.

Senator BOYCE—In this area, what were those sorts of things that you were telling Treasury about?

Mr Maloney—Managed investment scheme arrangements were created in 1998. At about that time, we were producing a very broad taxation ruling on what you needed to do to satisfy the deductibility provisions in relation to these primary schemes.

Senator BOYCE—Trying to apply the law that we then had.

Mr Maloney—Yes. We were trying to give guidance on the law as it then existed. In 1998 the managed investment scheme provisions were introduced into the Corporations Law. What were previously prescribed interest arrangements—and most primary production schemes were

prescribed interest arrangements—became managed investment scheme arrangements. There were provisions in the managed investment scheme law that seemed to us to require a conclusion that these were collective investment vehicles, that they were pooling arrangements and that they were really about retail investments. That did not sit very comfortably with the idea that the individual participants were carrying on a business. We sought advice about the structure of arrangements, having regard to the new managed investment scheme—

Senator BOYCE—Legal advice?

Mr Maloney—Legal advice, yes. We concluded that, provided the, what I will call, leasehold interests that investors get are not contributed to the scheme and therefore become scheme property, the individuals can still be considered to be carrying on a business. We issued product rulings for a number of years on that basis. Then there were two tax law cases, one was the Vincent case which was a cattle-leasing scheme where the court decided that investors were not carrying on a business and the other was the Puzey case which was a sandalwood afforestation arrangement where the court determined that a restructuring arrangement created a trust. That seemed to us to be very close to the trust arrangements that we thought existed in the managed investment scheme provisions.

Senator BOYCE—You are telling Treasury this.

Mr Maloney—At the same time, there were three Corporations Law cases over that period in the early 2000s that gave more indication, more focus, as to the scope of the managed investment rules. We thought that the way things were trending it might be the case that a Corporations Law decision, for example, indicated that investors might not be carrying on a business. There would be a clear issue for the commissioner, who had been giving product rulings saying that you were carrying on a business and then, for example, in a corporations case, to which he is not a party, the court might find that there was no business being carried on. We were mindful that it was a possibility that a court might decide that our rulings were wrong. That, if you like, was the catalyst for us to think what we should do about it.

Senator BOYCE—So you are saying to Treasury, 'You might have to legislate us out of this.'

Mr Maloney—Yes.

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.

Mr Quigley—There will be some, as we mentioned, where with agreement we stockpiled them over that period while we were waiting for test case funding.

Mr ROBERT—The comment will reflect that. In your experience, how many responsible entities exist per scheme?

Ms Martin—There is one responsible entity per scheme.

Mr ROBERT—Just one. Has there ever been any more than one?

Ms Martin—Not that I am aware of.

Mr ROBERT—Has there ever been any scope for more than one?

Ms Martin—At any time, no. There can be a change but there is not more than one at any point in time.

CHAIR—But there could be more than one scheme per entity therefore having different entities per scheme.

Ms Martin—The one responsible entity may have a number of schemes but a scheme will only have one responsible entity.

Mr ROBERT—Your written submission indicates, Mr Quigley, that in 2006 on the basis of previous court decisions the ATO reconsidered its view on the deductibility of investments. Can you talk the committee through exactly how that happened? Did the Federal Court release a ruling and then management got together with the ATO and thought that there was a problem?

Mr Quigley—There were the two tax cases that Mr Maloney was talking about as well as the three Corporations Law cases. That was really the process. Mr Maloney may want to expand.

Mr Maloney—Those five cases caused us to reconsider whether or not what we had been saying about the tax deductibility of the contributions was in fact true. We thought that the best way of being able to determine that was to have the question tested, which is what we did.

Senator FARRELL—I want to focus on a slightly different issue that you raise in your submission. You stated that the ability to work with ASIC and the ACCC to handle civil contravention is limited by the secrecy provisions of the tax laws. Would you like to comment on the fact that there is a growing focus on civil penalties in Australian corporate regulation? 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?

Mr Quigley—That to some extent goes to policy. We have the provisions that we have at present, but there is a review being undertaken of the secrecy provisions more broadly. Mr McCullough or Mr Miller might like to comment on that.

Mr McCullough—I am just trying to remember what stage the process is at with the secrecy provisions. There was a discussion paper issued a couple of years ago. The former government took the view that it needed to consolidate something like 18 separate secrecy provisions in various acts into one and, in doing so, identified a number of inconsistencies and consulted on changes that should be made. I recollect that a draft bill was circulated. That may have canvassed the idea of slightly expanding the ability to share information, but I think that is limited to criminal cases. I can check that for you and advise you if it is different.

Senator FARRELL—Thank you.

Ms Martin—If there is a serious crime we have provisions where we can provide information, but outside of that it is limited. We have general discussions but our ability to provide case specific information is limited.

Senator FARRELL—Thank you.

Senator WILLIAMS—If an MIS is established in the correct way when the land is purchased in regard to the regulations of the ATO, the land would be 100 per cent tax deductible. Is that correct?

Mr Maloney—The land used in managed investment schemes is not owned by the investors, who would have a leasehold interest or a licence to occupy. The land may well be owned by an entity within the promoting group or may be leased from an independent third party. The investors' contributions are for management fees, lease fees and licence fees but not for the purchase price of land.

Senator WILLIAMS—Are you aware of foreign investment in such schemes in Australia?

Mr Maloney—Not specifically.

Senator WILLIAMS—Thank you.

Senator McLUCAS—I have a question on the issue of land ownership. Have you read the forestry group's submission to us?

Mr Maloney—No, I have not.

Senator McLUCAS—I am fairly sure that there is a reference in there to a change to land ownership and to the fact that land is increasingly becoming jointly owned by the investors. Is that an accurate description?

Mr Maloney—I do not think so.

Mr Quigley—That is not what we have seen and, in fact, would be inconsistent with the tax deductibility.

Mr Maloney—There is an arrangement that we have seen in respect of which we have issued a taxpayer alert. It is an unusual structure which involves a land trust. To the extent that any investor contributions result in an interest in the land, there is a question as to whether or not they are deductible. If you are acquiring real property, that would be capital and not deductible expenditure.

Ms Martin—It is not the same arrangement as entering into an MIS. Our understanding is these land trusts may be offered to the investors, some of whom take them up.

Senator McLUCAS—It is a separate investment that would not have the same deductibility applications.

Ms Martin—It may have different deductibility but it may have the same investor party and they may invest in the MIS and in a land trust.

Mr Maloney—I think the fairly clear purpose of these land trust arrangements is to create a loss within the managing group, and that is what we think is challengeable.

Senator McLUCAS—In the CPA submission they say:

… many would argue that the damage had already been done …

They say:

… the uncertainty that this created negatively impacted the investment into non-forestry MIS over the relevant period.

That seems to be directly different from your evidence, Mr Quigley. I suppose I am picking up on the chair's question. How do we tease out whether or not the changed ruling post the court's decision impacted on the MIS?

Mr Quigley—As I have said, we were going on the industry data that was provided in that AAG 2008 annual report. That is the best available data that I am aware of. We came to the conclusion that there were other factors rather than the change of view and the test case funding. Again, this is going back to the practical arrangements that the commissioner agreed to in that transitional period. There was what was said: 'We won't apply this position until this time.' There was also the fact that investors that already had product rulings were still covered by those rulings provided of course that the arrangements were implemented consistent with the ruling application.

Senator McLUCAS—That AAG data is aggregated data, I dare say.

Ms Martin—It is aggregated. They also separated it into, I think, four categories that they had: afforestation, horticulture, viticulture and 'other'. You will see from their data varying patterns as to some increase and some decrease over periods of time. It is not conclusive; it is informative.

Senator McLUCAS—Right, so it is not conclusive. The forestry group's submission makes the comment, on page 10, that all of the funds collected from retail forestry investors quickly become taxable income in the hands of the plantation investment companies and their employees, contractors and suppliers and the investors later pay income tax on their net income from harvest. It says independent research analysts Australian Agribusiness Group have estimated that lifetime tax revenues to the government from all agribusiness projects can be as much as three times higher than the initial deduction entitlements claimed by the investors. Basically I am asking if you can confirm that.

Ms Martin—That is their estimation. I do not know the basis of their estimation. It is an estimation about the future. If you have a look at forestry arrangements you see they have a long life and many of them have not yet come to that stage. We have a look at or attempt to identify what actually has been returned to the tax system. I am unable to give that figure. All I am saying is that is an estimation, but many of them are still in the process of growing and have not reached harvest.

Senator McLUCAS—There are very few that actually have been harvested.

Ms Martin—That is right.

Senator McLUCAS—So it would be very hard to provide some figures that would support that statement.

Ms Martin—There are a lot of assumptions in there that we cannot validate. Obviously, it depends on whether the actual prices match the expected prices.

Ms GRIERSON—This is for my clarification. If I were an investor in an agribusiness managed investment scheme, would the tax treatment have been the same at the end of financial years 2006, 2007 and 2008?

Ms Martin—Yes.

Ms GRIERSON—So it would have been.

Mr Quigley—Sorry, so it was non-forestry that you mentioned?

Ms GRIERSON—Yes, that is fine. So that would have been the same at the end of 2006, 2007 and 2008. Take the end of 2009 when people have lodged their tax returns this time with companies going under et cetera. What would have been the treatment of their claims in their tax returns at that stage? What would have been deductible—anything, such as upfront fees, or everything?

Mr Maloney—For new investors in 2009 arrangements?

Ms GRIERSON—Continuing investors.

Mr Maloney—For continuing investors at this stage no change.

Ms GRIERSON—No change up to some of these companies going down, is that right?

Mr Maloney—Yes, that is right.

Mr Quigley—For non-forestry.

Ms GRIERSON—So even though there were these changing situations, the impact on taxpayers who had invested in these schemes in terms of deductibility had not really changed. Is that what you are telling me?

Mr Maloney—That is the unresolved question depending on what happens. There is the potential for secondary trading provisions to apply if there is a disposal of their interest in the scheme within the four-year period.

Ms GRIERSON—So how have you treated them? People would have lodged returns by now.

Mr Maloney—For 2009, no.

Ms GRIERSON—Sorry, it is the 2008-09 period that I am talking about.

Mr Maloney—They are due now.

Ms GRIERSON—They would just be lodging them now.

Mr Maloney—Yes, that is right.

Ms GRIERSON—Do you know how you are going to treat them?

Ms Martin—If the arrangement were implemented as intended they would get their deduction. There would be normal deductibility.

Ms GRIERSON—So what could impact on that to change that?

Ms Martin—The only thing that would impact on that is if they were not implemented in accordance with what was intended with the product ruling and then we would have to have a look at whether that difference gives a different tax outcome, which is the issue that Mr Maloney was referring to. Alternatively, I think somewhere there is also reference to not all of the trees—and these are not agribusiness ones; these are forestry ones—having been planted. They are the issues for which we are saying we are looking at our view on those.

Ms GRIERSON—In your submission you say:

We currently have under investigation for potential contraventions of the promoter penalty laws a small number of cases relating to MIS arrangements.

Can you tell us the sorts of infractions or breaches that you would be looking at? I do not want details as, obviously, when you have got an investigation underway that is not possible. What sorts of contraventions are you talking about?

Ms Martin—It is a small number. There are parts of the promoter penalty laws that potentially have application where an arrangement is implemented in a materially different way to a product ruling, which gives a different tax outcome. We undertake a risk review of all of the arrangements where we issue product rules for cases that we think are high risk. We go and have a look to see if they have been implemented in the way outlined in the product ruling. We also receive information from various parties at times expressing concern about some of the things they see in arrangements. We follow all of those up. We undertake risk reviews. In some of those areas we have had concern as to whether some of the crops have been planted in a way that was as intended so that would give the expected outcome—so where that is a material difference. There are others where they may have not fully disclosed the parties and there may be interposed parties between some of the investments. That is probably as far as I can really go with that. But I would say that these are where we are just looking at the arrangements. It is not conclusive. There is a range of outcomes that can come from that that.

Ms GRIERSON—You say you are working closely with ASIC and the ACCC. Are there specific areas that are ongoing? Can we expect that there may be changes and outcomes that will address some of these concerns so there may be some hope that we will see some real clarification?

Ms Martin—We talked before about how we have a somewhat limited ability to pass information on outside of the criminal sphere. We do have general discussions, but we do receive information from ASIC about their concerns and sometimes their concerns match our concerns at the same time, so we do have discussions about how we go forward and also at a general level. I think it is something where we see continued benefit in having more shared understanding of our various roles in the system to achieve good outcomes.

Mr Quigley—To clarify the tax implications, we are developing a draft tax ruling which will go out for consultation. It will deal with the myriad of issues that these circumstances raise.

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.

Mr Quigley—We will do our best but I am not sure we will be able to satisfy all of the—

CHAIR—It might be a good project for the ATO to undertake. You make reference in a range of areas to the fact that the ATO does not make a judgment on the commercial viability of schemes—and I do not think anyone would expect you to do that. But there are provisions for non-commercial loss. In your submission you referred to that applying from 1 July 2000. You said that the ATO is required to consider commercial viability in the context of quarantining losses. Can you explain how you do that.

Mr Maloney—Certainly. In the non-commercial loss rules there are four tests that need to be satisfied before the loss can be offset against your other assessable income. Where those tests are not met, the offset is not allowable and the loss is quarantined and can only be used against further income from that particular transaction or arrangement. But there is a discretion given to the commissioner in section 35-55. That discretion was designed to enable the loss to be offset where the tests were not satisfied through no fault of the investor—for example, where a natural disaster like a drought or flood impacted on the arrangements such that there was no income because the crop was lost or whatever. If it is reasonable to expect that, had that disaster not occurred, the deductibility requirements would have been satisfied then the commissioner can take the loss into account in determining taxable income.

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.

CHAIR—Thank you very much.

[9.40 am]

DRUM, Mr Paul Joseph, General Manager, Policy and Research, CPA Australia

ELVY, Mr Hugh, Head of Financial Planning and Superannuation, Institute of Chartered Accountants in Australia

FORREST, Mr Jonathan James Ross, Member, Institute of Chartered Accountants in Australia

CHAIR—Welcome to the Institute of Chartered Accountants in Australia and to CPA Australia, which is appearing via teleconference. I remind you that witnesses giving evidence to the committee are protected by parliamentary privilege. Would you like to make opening statements.

Mr Drum—CPA Australia represents the diverse interests of more than 122,000 members around the world in finance, accounting and business. Our members are in industry and commerce, public practice, government, not-for-profit and academia. Our vision is to make CPA Australia the global professional accountancy designation for strategic business leaders. We welcome the opportunity to present at this committee hearing today.

There are three points that I would like to put forward as part of these hearings. As well, I acknowledge that we lodged a submission on 26 June to this hearing. The three points I would like to put forward are, firstly, in this particular case it is Great Southern and Timbercorp that have failed rather than agribusiness products. Secondly, notwithstanding the fact that the product providers, rather than the actual investments, at this stage are the things that have failed, we still think that there is room for improvement as regards provision of information to investors and potential investors. In particular, one of our recommendations was that an investigation should be undertaken by ASIC or another government body to research past returns of different agribusiness managed investment schemes and that this information be made publicly available to help inform the market. This in fact is a recommendation we made to a previous Senate inquiry back in 2000 into mass-marketed tax-effective investment schemes, and evidence we gave in 2001. If that was ever undertaken, the information has to our knowledge never been made publicly available. Because of the risky nature of agribusiness, it would be very helpful to ensure that investors are making informed decisions. The third point I would like to raise is that we do have concerns about whether investors in these types of products are ever going to make fully informed decisions under the limited licensing arrangements and the AFSLs.

Mr Elvy—The Institute of Chartered Accountants thanks the committee for the opportunity to appear before it today. The Institute of Chartered Accountants in Australia is a professional body representing chartered accountants in Australia. It represents over 50,000 chartered accountants and 12,000 accounting graduates who are currently enrolled in our chartered accountants postgraduate program. Our members work in diverse roles across commerce, industry, academia, government and public practice throughout Australia, including rural and regional Australia and in over 140 countries around the world.

The institute's aim is to lead the profession by delivering visionary leadership and setting the benchmark for the highest ethical, professional and educational standards. We also represent the interests of members to government, to industry and to the general public by actively engaging our membership and local and international bodies on public policy, government legislation and regulatory issues. The institute represents a wide range of professionals who operate within the financial services sector and has a strong interest in this particular industry.

In its submission, the institute addressed a selection of issues that were raised in the inquiry's terms of reference and it has made comments where we believe it is most appropriate. We received feedback from our members, who include our rural and regional committee, which is why we brought Jonathan Forrest along with us; he is on our committee for rural and regional Australia.

Rather than going through all the details in our submission I would just like to highlight a few points and then take some questions from you. First, the institute would just like to acknowledge that there are benefits to the agribusiness managed investment schemes and that they have not all failed. Also, there are obviously some benefits for rural and regional Australia. The institute would also like to state that the agribusiness managed investment schemes were developed, promoted and distributed within the current regulatory and legislative framework. Generally, it does not appear that the promotion and distribution of these schemes was outside the regulatory framework that currently exists. The major issue that we would like to raise is the distortionary effect that exists, combined with the anomalies within the licensing regime, the remuneration models that currently exist within the agribusiness industry and, also, in regard to the tax implications and tax benefits that are actually there.

CHAIR—Did you wish to make an opening remark, Mr Forrest.

Mr Forrest—No.

CHAIR—You will have an opportunity to speak anyway. We have information that about 85 per cent of all MISs were actually sold through accountants. I find that figure to be unusually high. Can you explain—or if you have got another figure—why so many accountants would get involved in an advisory agent/broker type role with MISs when it is certainly not their core business and certainly not something that they are specifically licensed to do—in fact under the AFSR they are excluded from providing advice.

Mr Elvy—I am not aware of that 85 per cent of sales of MISs is with accountants. I am aware that accountants are involved with Great Southern, who had authorised representatives with them, and I know that about 80 of them were chartered accountants. For the remaining ones, who are part of financial planning dealer groups, I am really not in a position to make that comment. However, I will say that, because of the tax implications and tax deductions, inevitably accountants are involved with advice around taxation. Paul from the CPA may have further details.

Mr Drum—I have not heard that figure. I do not know whether I have much to add but for what it is worth we have had a look at Great Southern in particular and we note that there are about 1,100 sellers of the product at the time, according to their website. We had a look at those 1,100, of which 300 were meant to be accountants. We note that 'accountant' is not a regulated

term in Australia and anyone can call themselves an accountant. We had a look at the 300 to see how many were CPAs. Of them about 75 are CPAs, but I cannot really add to the matter of how much of the product was sold by accountants. But I mention the fact again that 'accountant' is not a regulated term in Australia. In respect of the profession, we know that in the accounting profession there will be institute and CPA members selling the product, but we cannot speak to how many products they sold or whether they are actually accountants, as we would know them.

CHAIR—It is either accountants, CPAs, through accounting firms or other bodies. It appears on the information that we have that, rather than an investment going through financial advisers or other types of agents, they have really gone much more through the accounting profession broadly speaking. The figure I have read is that roughly 85 per cent of all schemes were actually sold through that type of an arrangement and that they were licensed under the holder of the AFSL. So they were acting as a broker for the scheme specifically. Are you concerned at all with people, be they accountants or otherwise, giving advice when they only have one product on their book, that being an MIS?

Mr Elvy—One of the issues that we raised in our submission as a concern and an anomaly within the licensing regime is that you can actually be limited to advising on one product from one provider—and, particularly in the case of Great Southern, a tax-effective agribusiness product was the only area that you could advise on. We believe that that is a concern and something that the PJC inquiry into financial products and services should address. We do not believe that, if you are providing investment advice to consumers and investors, you could adequately understand the consumer and give them all the options if you are limited to one or two products. We do not believe that that is appropriate.

Mr Drum—CPA Australia shares the same concerns. In fact, the third point that I raised in my opening statement was that, under the limited licensing arrangements, it does not seem possible that an investor is getting holistic investment advice.

CHAIR—In terms of the role that your members or people in your profession played in these schemes, would they have made any decisions based on the commercial viability or the long-term investment potential or returns? Would they have looked beyond the immediate up-front tax deduction and advised their clients on what type of investment they are actually getting involved in?

Mr Elvy—The advice they are providing as authorised reps would mean that they would have to have an understanding of the actual product, its viability and all the issues associated that—not only knowing the client but also the product. So we have an understanding that that would be part of their initial training to be accredited to advise on those particular products. As to the depths at which they actually go through the commercial viability and so on, I am not sure.

Mr Forrest—As a member in public practice and also from the point of view of holding an AFSL we would certainly look at commercial viability of any investment that our clients were investing in. Certainly our firm's point of view was that the tax-driven MISs were something that we were not promoting with our clients. We share the institute's view in terms of the distortion between just the tax result of an investment versus the long-term viability. One of the major concerns of the institute is just the tax-driven focus of these investments.

CHAIR—Mr Drum, did you want to add something?

Mr Drum—Yes. While of course we cannot speak on behalf of individual members, I would just like the committee to note that, 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.

CHAIR—How would that work in practice, given that the people we are talking about, we can assume, are at the top of their profession—that it is a profession, that they are licensed in some way to be able to provide that advice, whether it is for one product or many and given that we also have with Great Southern, Timbercorp and others annual reports which actual stated in black and white that the immediate returns on these were actually going to be less than the outgoings, the liabilities, and that in fact they probably could not meet their liabilities? If somebody had just read the annual report, they could have read in black and white that these schemes would not make money and in fact were in financial difficulty and yet professional people still advised that they were a good investment. I just find that hard to believe, given that I have read the excerpts of those annual reports which clearly state from the company themselves, 'We are not going to make money; in fact, we will struggle to survive unless we can get more people signed up to the schemes'—almost in a pond style manner. How is that possible in practice?

Mr Drum—I cannot shed any light on that for the committee. With the benefit of hindsight it seems quite evident that these schemes did not have much of a future. However, as I said, that is with the benefit of hindsight. I am not sure.

Mr Elvy—I think if you looked at the number of accountants who advised on that versus the number of accountants in public practice, proportionately you would probably have a smaller number who were advising on these particular products. Anecdotally, I know that of the vast majority of members whom I have asked in the last three months: 'Have you had any exposure to agribusiness' I have not come across any who have said, 'Yes, I'm really stuck because of it.' So, yes, 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.

CHAIR—Mr Drum, you said that with the benefit of hindsight these things are obvious, but what I am actually saying is that you do not need hindsight; all you needed to do was read the annual reports. These schemes were telling people via their annual reports that they were not viable. That is really my question. A lot of submissions tell us that what we need to do is improve disclosure and information to the market, that the regulators need to do more and so forth, yet the annual reports state in black and white: 'We are not going to make it'—and you do not need to be an accountant or a financial adviser to be able to read that. I read those and it was pretty obvious to me just in one paragraph that the auditors and the people reporting on the

company through their annual reports were actually saying that these schemes were not viable. So my question revolves around how professional people, whether it is a large number or a small number—certainly a large percentage of the schemes were sold through people who claim to be accountants or otherwise—can legitimately advise anyone on any scheme, regardless of the tax deductibility, if they are not at all commercially viable.

Mr Forrest—As Hugh and Paul said, obviously in those cases there are schemes that have not performed. There are also schemes that have performed. I cannot speak for other members in public practice, but certainly as a member in public practice we would be looking at those things in advising any investment, whether it be an MIS or an equity investment, say. Certainly from a practical point of view as a professional adviser we would go through the process of looking at the performance of the underlying investment.

CHAIR—Are there any conduct issues in your own organisations and among your members who actually did advise? I do not mean whether they advised on successful or unsuccessful ones, but the ones they did advise on were unsuccessful, given that their annual reports stated the financial problems they were facing. Are there any conduct issues? Did they just advise people: 'This is a really good tax break. Just jump in; we'll read the detail later' or were they advising properly in terms of what they are required to do?

Mr Elvy—I am not in a position to comment, as Jonathan said, on all members and how they have operated. Part of the issue revolves around a combination of issues. Not just the tax deductibility but also the remuneration models have also caused a significant bias and potential behaviour in advising on these particular products. The institute has been very vocal over a number of years about pushing the whole idea of a fee for service as opposed to remuneration for the sale of a particular product. I appreciate that, yes, when you look at the annual report and ask how the profession could advise on that, there are a number of issues surrounding that which have influenced the behaviour of some accountants.

Ms GRIERSON—Mr Drum, you said that your organisation had sent out cautionary information to members. Have both of you scanned what information you did send to your members in newsletters et cetera regarding MISs? Could you tell us about that information.

Mr Drum—I am happy to table the document for the committee. As I said, we have an annual warning that goes to the market about the inherent risky nature of agriculture and agribusiness managed investments schemes. That would be by way of media release, a public statement and media that we consequently ran about that. Things that look too good often are. We have run other marketing campaigns over the years. For example, some years ago we had some brochures printed which had a picture of an olive with the by-line: is this a lemon? It was sending the message that agribusiness is risky, be careful what you go into—

Ms GRIERSON—So you are saying that you have had a consistent position with your members regarding being upfront about the risk.

Mr Drum—Absolutely. I have been at CPA Australia since 1996 and it has been an annual message since that time. I also mention that in 2007 rather than just a year-end statement we issued a five- or six-page guidance note that looked at the issues to consider if you are going to advise on agribusiness managed investment schemes. It looked at the profitability, inherent risk,

droughts and commodity markets—all the things that you should be considering before you advise a client and that the client should be considering before they invest in these types of arrangements. I am happy to table that for the committee.

Ms GRIERSON—Mr Elvy, can you say the same for your organisation?

Mr Elvy—We have communicated with our members on a regular basis on the risks associated generally with investments and that where you are providing advice you need to understand the product. We have not put out brochures similar to the CPA's or anything along those lines with warnings with regard to agribusiness; however, we have stated in all our correspondence with members that, if they are providing any investment advice, they must understand the risks and their clients must understand those risks.

Ms GRIERSON—Did you ever promote them to your members?

Mr Elvy—They have promoted their products through some of our magazines.

Ms GRIERSON—Do you mean in terms of paid advertisements?

Mr Elvy—Yes.

Ms GRIERSON—Has there been any editorial support for that?

Mr Elvy—Not that I am aware of.

Ms GRIERSON—Are these companies major sponsors of the CPA or the institute for conferences or whatever?

Mr Drum—No. If we went back to the last century, I would expect to find that we would have had sponsorship from some of these types of companies; however, as I mentioned before, since the Senate committee of inquiry into mass marketed tax-effective investment schemes in 2000-01 CPA Australia have chosen to not take sponsorship money and marketing money from businesses that are in this business because we do not want to be seen as tacitly approving these types of investments in the market.

Mr Elvy—The institute has taken sponsorship money from Great Southern in the last 12 months and I am not sure about prior to that.

Ms GRIERSON—Some 85 per cent of the advisers pushing these products were accountants—the chair's statistics. Do you think the tax deductibility aspect was more attractive to accountants rather than weighing up the investment benefits? Do you think there is a leaning by accountants to look for tax deductibility?

Mr Elvy—I would say that the tax deductibility distorted between managed investment schemes and some of the alternatives there. I would say it is a combination of tax deduction—and obviously with accountants providing tax advice—and, as I mentioned beforehand, you also have the issue of the remuneration of basically paying up to 10 per cent commission. I think that combination was fraught with danger.

Mr ROBERT—I want to get to the bottom of this 80 per cent figure. Mr Drum, you indicated that there were about 1,200 people who advised on products on Great Southern's website; is that right?

Mr Drum—I might have said 1,200, but I think it was 1,100 mentioned on Great Southern's website.

Mr ROBERT—And you indicated that 75 were CPAs; is that right?

Mr Drum—Around about that, from what we have been able to deduce so far.

Mr ROBERT—Give or take. Mr Elvy, you indicated how many were from Chartered Accountants or chartered accounting firms?

Mr Elvy—Of the 300 who are authorised with Great Southern, we understand about 80 of them were from Chartered Accountants.

Mr ROBERT—Therefore, about 155 of the 1,100, which is about 15 per cent, were either from Chartered Accountants or CPAs—that is what I am hearing in the inquiry; is that correct?

Mr Elvy—From the numbers that you have provided, yes.

Mr ROBERT—I am not a mathematician but therefore 85 per cent of people who provided advice were not CPAs or from Chartered Accountants.

Mr Drum—Correct.

Mr ROBERT—Great. Can anyone provide any advice to me as to where all the media of reporting is coming to say that 80 per cent were accountants when in fact what you are saying is that 85 per cent either were not from Chartered Accountants or were not CPAs?

Mr Drum—We think some of that is a bit of hubris. It is a case of the facts not getting in the way of a good story. We think it is just a bit of a myth.

Mr Elvy—There would still be some accountants who worked under a dealer group, which may well come under that remaining 1,100 also.

Mr ROBERT—What percentage of the accounting profession is either not a member of CPAs or not a member of Chartered Accountants?

Mr Elvy—I am not aware.

Mr Drum—I could not answer that, sorry.

Ms GRIERSON—You do not know your market share?

Mr Forrest—Not us personally. I know there is data on that because I have seen those figures previously through our regional advisory committee. There is the National Institute of Accountants and other organisations.

Mr ROBERT—Are you happy to provide that information to the committee on notice?

Mr Forrest—Yes.

Mr ROBERT—I am just interested because you are saying that only 15 per cent of those on selling Great Southern products were members of the two premier accounting associations in the country.

Mr Forrest—Where has the figure of 85 per cent come from?

Mr ROBERT—You have said that 75 were members of the CPA and 80 were members of Chartered Accountants. That is 155. If there are 1,100 members who are on selling Great Southern, give or take—

Mr Forrest—Excuse me. That is probably more a question to the chair of where the figure of 85 per cent—

CHAIR—As I said earlier, it is just a figure that is out there. There is a general comment saying that about 85 per cent of the schemes were sold through accountants. That could be whatever definition you like to place on accountants. As you said earlier, Mr Drum, it is not a regulated term.

Mr ROBERT—Far be it from me to question the fourth estate—heaven forbid!—but it would be nice to work out where the numbers are coming from. But let us work on the premise that only 15 per cent were from the two professional associations on selling one product, Great Southern. We can take that at face value, I think. There are nods from the bench. Can I deal with submissions, which is the other issue which is getting some airtime in the fourth estate? My understanding from reading everything, including information put forward by you, was that the standing commission was, give or take, around 10 per cent.

Mr Elvy—Yes.

Mr ROBERT—My understanding is that it was a one-off fee, generally.

Mr Forrest—In general terms, yes.

Mr ROBERT—However, as professional accountants, I gather you would be providing advice to your clients for the long term of the investment.

Mr Elvy—Yes.

Mr ROBERT—What is the long term of an MIS? How long is the investment? Is it 10, 15 or 20 years?

Mr Elvy—It depends on which agricultural product it is. It could be six, seven, 10 or 20 years.

Mr ROBERT—If it you are providing advice for 10 years, advertising the 10 per cent upfront, is that about one per cent per year on advice?

Mr Elvy—Yes.

Mr ROBERT—What is your standard fee for advice, in general terms?

Mr Elvy—I am not in a position to say what our standard advice fees are. However, I would like to reiterate that the institute's position has been very much that remuneration models should be based on the provision of the advice as opposed to the product. Irrespective of what product is actually selected or chosen at the end of the day, remuneration should be on the advice that was largely given.

The issue in regard to the 10 per cent we see as potentially providing a conflict of interest—be it real or perceived. Yes, I have heard the argument, 'You are paying 10 per cent upfront, which is really advice for the longevity of the investment.' The institute's position would be that really you should be charging a flat fee for advice on an ongoing basis rather than in an upfront manner.

Mr ROBERT—Mr Drum, do you have a view on the future for commission based versus up-front fee models for services?

Mr Drum—I will just add to our colleagues at the ICAA. CPA Australia does not have a scale of fees. For example, I understand the legal profession had indicative fees—what their members should be charging. The accounting profession, as far as I know, does not have a scale of fees in that regard—and certainly CPA Australia does not in that regard. I would also be in accord with everything that Hugh has said with regard to preferring fee for service. We are not against commissions, but you really should be getting value for your money and you should be disclosing to the client what you are actually charging them for. They should know up front what they are actually paying for and how much it will cost.

Mr ROBERT—Mr Elvy, how do you respond to the argument that may be raised in that it may be 10 per cent up front but, amortised over 10 years, the life cycle of advice on an MIS product is one per cent per year?

Mr Elvy—I am not in a position to clarify the value of the advice being provided and whether that is worth one per cent per annum. The institute's view is very much along the lines of a percentage based fee structure—rather, a flat fee structure—based on the skills, complexity and time associated with the advice being provided. Our view is that, when you use percentage based fees, you really have to advise someone about purchasing a product as opposed to them just receiving the advice. I would not be in a position to say whether or not 10 per cent, amortised at one per cent per annum, is necessarily a value on advice.

Mr ROBERT—If I could follow on from a point the chair made with respect to submissions: a number of organisations or, indeed, individuals, hold an AFSL and only sell one product, that

being a MIS. Considering the MIS product in gross general terms had a 10 per cent, give or take, fee up front, is there a conflict of interest in a provider holding an AFSL and only selling one product—providing no other advice outside that product—and, of course, using a commission based model?

Mr Elvy—We would believe that a conflict would exist, whether that is real or perceived. If you have a licence and you are only advising on one product and you have a high level of commission, inevitably there will be some sort of prejudice or bias in that.

Mr ROBERT—Mr Drum, do you have a comment on that?

Mr Drum—We share the same views. For investors, if a complaint is raised, these are matters that would be looked into.

Senator WILLIAMS—Mr Elvy, as far as the impact of managed investment schemes on rural and regional Australia is concerned, you say in your report:

... its rapid growth has resulted in a range of distortions to the agricultural market.

Would you like to expand on that?

Mr Elvy—The main issue that we were raising there, and from discussions with our regional and rural committee, was that the amount of funds and capital flowing in from these managed investment schemes were, for example, increasing the price of land. Therefore, the locals in rural Australia could not compete. When it came to purchasing water and things along those lines, the MIS schemes obviously had a lot more funds and, therefore, local people within rural and regional Australia found it difficult to compete.

Senator WILLIAMS—So you are saying that, because of the tax breaks et cetera of an MIS, when they purchase land, or in relation to the deductions, they could pay more and, hence, that forces the price of the land up and the genuine family farmer, who may have been there for five or six generations, would find it hard to purchase land if they wished to expand their enterprise?

Mr Elvy—Yes. Similarly with collapses: if they have to sell the land, the price of land could actually be falling at the moment. Where local farmers and so on have possibly borrowed more, because land prices have gone up, their loan price has fallen. There is a distortionary effect there.

Mr Forrest—The other thing that we have seen anecdotally is the impact on the employment market locally. In a lot of those areas it creates an unlevel playing field in relation to employment, in terms of wages going up that are being offered by the MISs compared to other industries within those regions. There is also potential oversupply within some of those industries. If you look at the viticultural industry as an example in terms of the oversupply of product into the market, that has certainly been a big factor. There is misallocation of land and water resources across the board.

Senator WILLIAMS—If you went into the forestry side of an MIS, once it was established there would not be a lot of jobs left in that particular block of land, would there?

Mr Forrest—No, and that is certainly the other concern, the impact on regional communities and development.

Senator WILLIAMS—Ongoing employment.

Mr Forrest—Correct.

Senator BOYCE—I want to follow up, Mr Drum, some earlier questions and your earlier comment around the fact that the term 'accountant' is not a regulated term in Australia. In your experience, or in your association's experience, who is holding themselves out as an accountant who should not be?

Mr Drum—I do not know whether it is a matter that they should not be; they are not a member of the profession, though. Because it is not a regulated term, they are not doing anything unlawful. For example, there would be people who are registered as tax agents under the tax agents laws of the land that are not a member of the profession and therefore on their shingle they might have registered tax agent and accountant.

Senator BOYCE—But they would have an accounting degree.

Mr Drum—They would have done the requisite subjects at the undergraduate level to ensure that they passed the tests required, the eligibility tests and criteria, to register as a tax agent. Whether that is a full accounting degree or not I could not comment at the minute.

Senator BOYCE—Is this an area of concern? Is it something this inquiry should be considering, from the point of view of both your associations?

Mr Drum—We prefer that all accountants are a member of our organisation.

Senator BOYCE—Yes, but that was not the question.

Mr Drum—My apologies. We are not seeking to have the term registered and regulated in that way; we are just making the point that it is not regulated in Australia. So I guess going back to earlier comments about media reports and who has actually been doing allegedly dastardly deeds, it is not necessarily the profession and it is not necessarily professional accountants, although we admit that we do have members who have been selling product.

Senator BOYCE—I am having trouble finding this reference, but I think it was your submission that said that suggested that the uncertainty around the tax deductibility issues and the ATO ruling contributed to the failure of the forestry MISs. Am I correct in that?

Mr Drum—With respect, I do not think that was part of our submission. We have not chosen to comment on that, to the best of my knowledge.

Mr Elvy—Could you repeat what the question was? We touched on the issue of tax deductibility but I do not think we did on the uncertainty.

Senator BOYCE—Sorry, it may well have been your submission, Mr Elvy. Just in terms of one or other of your organisations looking at the issues that you consider to be relevant to the collapse of Great Southern and Timbercorp, one of the issues mentioned was the uncertainty over what was about an 18-month period, I think, on the tax treatment of these groups.

Mr Elvy—I do not think we actually covered the issue of uncertainty in terms of tax deduction and the tax issues. We raised that the tax deductibility increased the distortionary effect that we believe contributed to the collapse of Great Southern and also Timbercorp. Our view was that there has been a lot of discussion about changing what the tax deductibility should actually be with regard to agribusiness managed investment schemes and that tax is not the only issue that needs to be addressed. We did put forward a couple of alternatives, such as a quarantining effect and so forth.

Senator BOYCE—The purpose of the question is that the ATO said they had put a lot of work into ensuring that there was no effect on the viability of the schemes caused by the hiatus while court cases were proceeded with. Would you agree with that view of the ATO's?

Mr Elvy—I am not in a position to comment on that. I am still not sure in terms of what you are saying about the uncertainty. I do not think we made a comment on the uncertainty.

Senator BOYCE—Well because there was a pending court case and because there had been product rulings and then there was a change I thought I had read that that was a contributing factor to be collapses of these schemes.

CHAIR—Some people have made the claim that that period where the tax office had made a particular product ruling in terms of MIS had caused uncertainty and that therefore that contributed to the collapse of Great Southern and Timbercorp.

Senator BOYCE—I am sorry, I thought it was one of your organisations that made that comment.

Mr Elvy—I do not think it was us so I am not in a position to comment.

Senator BOYCE—I will not pursue that if that is the case. On the lost quarantining mechanism that you mentioned, would you like to explain that to us and a bit more?

Mr Elvy—As I mentioned earlier, one of the concerns the institute does have is blaming the corporate collapse and so forth on the tax implications and the tax deductibility. The institute has a real concern about making significant changes to the tax options and the taxation rules because the agribusiness managed investment schemes operate under the current business tax rules and we would not be supporting making exemptions or changes just for the agribusiness industry. One of the key areas we were really looking at in our discussions we had with our rural and regional committee and so on was: are there some alternatives? Some would argue that the tax deductibility was the big issue and that tax influence is the big issue as far as these collapses are actually concerned.

One of the suggestions that was brought up by our tax team was basically quarantining the tax deductibility would be attributed to the income that you are actually receiving from the particular

managed investment scheme that you are actually investing into. So therefore you are quarantining that deduction to that investment area rather than across the board.

Mr Drum—Just for the record, CPA Australia could not subscribe to that. I know that that is what our colleagues have put up as a possible option but it is not something that we would subscribe to.

Senator BOYCE—Why is that, Mr Drum.

Mr Drum—For multiple reasons. As the committee will appreciate, this is a very complex issue that we are dealing with. Australia needs to have vibrant industries. I read in the papers on about 28 June that we have just re-signed with Japan to export woodchips to them at $207.40 a tonne. We are a major exporter of woodchips. So we have to weigh up whether this industry is viable. It seems as though there are markets. We have other major players, as you know; there are still at least five readily identifiable players in this market in respect of agriforestry and agribusiness. Certainly there are risks but the question is: what does the product offer have to be for the product to actually get off the ground and be successful?

The tax deductibility is certainly a feature of this investment; and it is necessary to really make it work, I would say. If you quarantine it, then, for example, if I decided as an accountant that I wanted to invest in agriforestry, I could not claim the deduction unless it is against other agricultural type income. If I have invested in trees then there will not be any income or 12 years. So I have this loss that I am carrying forward that I cannot offset against. So I have had an economic loss, an economic outgoing, and I cannot deduct it against anything for 12 years. Even if I enter into a new scheme the next year and a new one the next year after that, it is still going to be 12 years before I can claim my first lot of deductions. That is not an economic burden that I would be prepared to carry as an investor unless the returns were remarkably different. I think that needs to be factored into the thinking about quarantining. It is not a general proposition about quarantining losses from other activities, but certainly in respect of investments that have a very long gestation period before there is income it creates another set of problems.

Senator McLUCAS—Mr Drum, I would like to take you to section 9 in your submission. You go through the history of what occurred and you say:

> The ATO then withdrew TR 2007/8 but many would argue that the damage had already been done and the uncertainty that this created negatively impacted the investment into non-forestry MIS over the relevant period.

In earlier evidence I read that to the witnesses from the ATO and asked them if they agreed. They said that they did not and they referred to Australian Agribusiness Group data not supporting that position. On what basis do you say ‘many would argue that the damage had been done’ because of the change in position that the ATO had?

Mr Drum—Certainly that has been some of what we have read about this. I know we put that in our submission. We are not saying emphatically that that is our position but anecdotally others are arguing that. For example, in one of the submissions to this inquiry which I have read, I cannot recall exactly which one it is, there is a graph that shows the share prices of Great Southern and Timbercorp. It has arrows on it indicating where the share price has actually gone down and one of the turning points is actually the ATO ruling issue. So the price has dropped.

They are saying that this was reflected in the market because this is where there was uncertainty. I can get back to the committee and find that but it is in one of the submissions made by others. As I said, so it is not a point that we actually emphatically making—that that is the case—but we are saying that, from what we have heard, and we can reasonably expect people to assume, this certainly did not help.

Senator McLUCAS—I suppose I would like something a bit more concrete than 'one would reasonably assume'.

Mr Drum—Again, it is not a point that we were making emphatically; it is an observation, I guess.

Senator McLUCAS—Going back to the people who were selling these products—that is, accountants et cetera—could I assume that all of those 155 CPA members and institute members had an AFSL?

Mr Elvy—My understanding is that they were all authorised representatives operating under an AFSL.

Senator McLUCAS—So they were authorised representatives working under an AFSL holder?

Mr Elvy—Yes.

Senator McLUCAS—How does that relationship work?

Mr Elvy—A corporation applies through ASIC for an Australian financial services licence. They have a set range of terms and conditions in terms of how they actually operate. That will include whether that business will be providing advice or dealing in a range of financial products. From there they will basically appoint or authorise individuals to advise on their particular products. There is a compliance requirement in terms of meeting ASIC regulatory guide 146 training whereby if you are going to advise on managed investment schemes or managed investments then you have to have done an ASIC approved course, which is on the ASIC register. You then come under the supervision and monitoring of the Australian financial services licence in providing that advice. That therefore incorporates needing a statement of advice when you are advising and all those sorts of associated things.

Senator McLUCAS—And what is the nature of that training which you have referred to?

Mr Elvy—It ranges. Specifically for those who are actually operating under the Great Southern Australia financial services licence I am not aware. Generally speaking there are a range of training providers in the market. The training is required to be at diploma level. There are seven specialist knowledge areas—so if you are providing a full range of advice in superannuation, life insurance, managed investment schemes, securities and derivatives. That training can be face-to-face workshops, online or through distance education. It is one of the areas that we have previously raised in other inquiries—that is, the whole issue of training as far as financial advisers is concerned. It really needs to be reviewed, because we believe that the

current level, which is RG146, is the minimum level and that that level is really too low to be advising on financial products.

Senator McLUCAS—If you were an accountant and you wanted to become an authorised representative, how long would that training take?

Mr Elvy—I understand it can take as little as nine days, or you can do a postgraduate course. You can do a graduate diploma in applied finance, which would take maybe two or three years. But I understand you can do a course in nine days to become a financial adviser.

Senator McLUCAS—Thank you.

Mr ROBERT—Mr Elvy, are you saying that I could do a course in nine days and get an AFSL limited to selling MIS?

Mr Elvy—You could not get a licence in that time; you could become an authorised representative to operate under somebody else's licence. To go to ASIC and go through the application process would take significantly longer. It could take months to receive your Australian financial services licence through ASIC. You can do a nine-day course to become an authorised representative to advise on particular products and call yourself a financial planner.

Ms GRIERSON—Back to tax minimisation and the attractiveness of that for clients. We do not want to see another risk situation emerge. What product has replaced that in terms of tax minimisation attractiveness? What are accountants now advising their clients to invest in if they are looking for tax minimisation?

Mr Elvy—From the tax minimisation side of things, there are the benefits, for example, in superannuation—

Ms GRIERSON—Yes, that is one very attractive product.

Mr Elvy—because the tax is at 15 per cent. Similarly there are some insurance products.

Ms GRIERSON—There are genuine offsets for people. So is there a flavour of the month at the moment that we should be aware of?

Mr Elvy—I am not aware of a flavour of the month at the moment in terms of alternatives to the agribusiness managed investment schemes.

Ms GRIERSON—Okay, thank you.

CHAIR—You have both made reference to the differentiation between accountants and financial advisers. Should there be a clearer, regulatory definition? Should there be a neater way of knowing who is who, so that we can ask questions and understand whether they are who they purport to be?

Mr Elvy—I think one of the challenges is that you have accountants who are authorised representatives who then also operate as financial planners. In many cases you have accountants

who are 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.

CHAIR—Is it not even more of an issue for accountants and not knowing who is an accountant and who is not? We do not seem to be clear on who accountants are let alone who financial advisers are.

Mr Elvy—How do you define what makes an accountant?

CHAIR—We do not really know who accountants are. When we talk about figures and percentages, it is all esoteric.

Mr Forrest—Within the profession, you are a member of the professional body.

CHAIR—Yes, but the profession is just one group.

Mr Forrest—It is more a question for the general public. Probably most of the public would be confused.

CHAIR—It is by membership and it is voluntary. No-one is compelled to join your organisations.

Mr Drum—I think the debate around who is an accountant or not is really a red herring. The real issue is whether the person who sold the product is an authorised representative. Were they registered appropriately under an AFSL holder and with ASIC? It does not really matter what they were. I think it is a red herring. It could have been financial planners, it could have been accountants or it could have been Joe Bloggs the salesman.

Mr Elvy—Part of the issue also in selecting and using an accountant is the value in accountants who are part of a professional body—ourselves and the CPA. There are a lot more rules and regulations being part of the profession than being a stand-alone accountant as such.

CHAIR—Thank you very much.

Proceedings suspended from 10.34 am to 10.54 am

BLOCH, Ms Jo-Anne, Chief Executive Officer, Financial Planning Association of Australia Ltd

HAINTZ, Mr David, Director, Financial Planning Association of Australia Ltd

CHAIR—Welcome. Do you have any comment to make on the capacity in which you appear?

Mr Haintz—I am a certified financial planner with 21 years experience running a financial planning business.

CHAIR—Thank you. I invite you to make an opening statement.

Ms Bloch—Thank you very much. The Financial Planning Association represents nearly 12,000 members, of which 550 are Australian financial services licensees, representing about 80 per cent of the industry. About 9,000 of our members are individual financial planners, and that represents about 60 per cent of what we believe to be the true, genuine financial planning population—and I will explain what I mean later.

What we would like to do, very briefly, is to talk about the role of financial planners and FPA members in relation to these agribusiness managed investment schemes, talk briefly about what we think went wrong, talk specifically about the difference between the corporate entity that managed these investments and the investments themselves and highlight some recommendations for improving the regulatory framework to improve consumer outcomes.

The information that we have is difficult. We wish we had a picture of who was involved in what in terms of Great Southern and Timbercorp. We talk on behalf of our membership only. We conducted some research amongst our Australian financial services licensee members, the 550 members—to which we had a response rate of about 30 per cent—into their potential exposure to managed investment schemes. From that, we think that something like half of our licensee members had some exposure to agrischemes, but what must be said is that, when we looked into that, we found that the actual investment was of a diversified nature and tended never to be more than 10 per cent of a particular client's investment portfolio. We make that point very clearly because that is in contrast to some of the other people that were involved in the distribution of these products.

The collapses of both Great Southern and Timbercorp did come as a huge surprise for our members, because a number of these investments were highly rated by independent research houses, because they had the regulatory framework provided by the Stock Exchange, ASIC and the ATO and because for some time these have actually been good investments. Since then, our members have been very focused—with all their energies, in fact—on protecting investors' interests, protecting the investments and trying to redeem some of the quality of the investments that remain, noting that, as far as we are concerned, the problem really relates to the corporate entity itself.

FPA members sign up to a code of ethics and rules of professional conduct. They are financial planners, and the role of financial planning is clearly very different to the role of distributing

product and, in many cases—as is the case—the role of simple authorised representatives. Financial planners work for licensees. You talked about that in the previous session. Licensees provide the controls around the products that have been referred to. There are a number of controls inherent in the licensing system. You need to have robust systems for approving products, you need product accreditation training, there are strict compliance requirements, there are protocols around disclosure and there are certainly really tight controls around the use of various products by financial planners.

The FPA does not get involved in product selection, product commentary or any of those issues. Our concern is very much around the role of financial planning and financial planning advice and whether that advice meets with our code of ethics and rules of professional conduct. We assume it is legal. In fact, ASIC would step in if it were not legal, if there were breaches of the law. We are very concerned, with regard to the existence of these schemes, that our members have provided good advice. Our preliminary investigations—and it is only early days—indicate that this is not an issue around poor advice, because of the controls that were in place, because of the strong licensee and compliance arrangements that existed. Our early indications are that the issues surrounding these investments were around the failure of the corporate entities, the use of the term 'authorised representative' and the selling nature of some of that under the guise of advice, and misunderstanding about the role of the tax office, ASIC and the ATO, the role of the responsible entity and, to some extent, influences and incentives.

To that extent, we do not argue that commission in fact was the issue, noting of course that the FPA has recommended that our members move away from commission based advice. We do not think commission was the issue; we think the high level of commission was potentially a bigger issue. We would argue that, if there were higher than average levels of commission in play, investors would need to be very clear about what that commission was for, what the value of that payment was and whether they were comfortable with that.

David Haintz, as I mentioned, is a certified financial planner and is certainly able to talk to you in much more detail about the types of investors, the types of choices they might have and those sorts of issues.

My closing comments relate to the fact that we believe one of the biggest problems in all of this was that you had a single product vendor. Great Southern and Timbercorp had their own licences; they authorised people to promote the product under the guise of advice, because they were called 'authorised representatives'. When you have a single licensee selling a single product, it is not advice. It is no surprise that people ended up with large exposures. It is of concern that, in contrast with financial planners, who provide strategy and a diversified portfolio, authorised representatives have incredibly low levels of competency and minimum entry requirements: regulatory guidance 146 is way too low. We have long argued this and it is about time we did something about it.

We absolutely agree with you, Chair, that it is time now to determine the difference between the 45,000 product advisers out there and the genuine financial planners who are out there, so consumers know when they are buying a product and when they are getting advice—when they are getting a strategy, there are options, there are different choices; it is a completely different thing. The market at the moment is not clear, the consumer is invariably confused and it is no

surprise that some of these issues have resulted from product promotion under the guise of advice.

We really need to make sure that the disclosure regime is clear in relation to who is promoting the product and in relation to some of the more detailed issues around the corporate entities. We can go into that later. We have concerns about the responsible entity and potential conflicts of interest. We have concerns about higher than average remuneration. We have concerns about licensing. Most of all, this was a higher than average risk type investment, and we would argue that clients need to understand the risks inherent in that type of investment, one being that it was based on a tax deduction. Having said that, that is not to say that these were necessarily bad options, and David can speak to where they would in fact be good investments and where there would be positive outcomes. Nonetheless, these products no doubt represent higher than average risk type investments, and it is important that consumers, investors, who go into them understand that very clearly. David and I are of course happy to answer any questions.

CHAIR—Thank you. I will start off by asking you why you think it might have been the case that about 85 per cent—we are using the figure that has been reported through the media—MI schemes were done through broker type arrangements but ultimately sold through accountants. Do you have a view as to why they might have been sold through that mechanism?

Mr Haintz—I think the companies involved probably saw an opportunity to use a relatively straightforward distribution system to have a single licence and a single product. Rather than going through the genuine financial planning space and process that our members would adhere to, it was far more straightforward for those companies to get sales more quickly where they had a single product and a single solution.

Ms Bloch—I would add that I think 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. As authorised representatives they have minimum entry requirements, and we are not very clear on what sort of training occurred or how that process is carried out. But we are certainly very clear, from a licensing point of view, where financial planners would have used or recommended the product. There are pretty tight controls on product training competency and so forth.

CHAIR—Do you think there is a blurring of roles or of responsibilities when somebody is predominantly of one profession—say, an accountant, if we are referring to MISs—but also take on this other role for which they might have done a one-week online course to qualify for being able to sell and provide advice on only one type of product? Do you think there is a conflict there? Or can a person wear the two hats—so, be a fully qualified accountant wearing that hat and also be, let us say, a fully qualified, licensed financial adviser—or be some vagary in the middle?

Ms Bloch—Yes, I think there is a concern. Whether it is a conflict is yet to be determined because, again, accountants have professional obligations, depending on which association they belong to, of course. The issue is that the same thing has happened with the self-managed super fund sector. Accountants have been given an exemption from licensing to promote one superannuation product, yet there are four others. Our concern is this: is the client being given

the appropriate options; is the client being given strategic advice; is the client being told what the spectrum of possibility is? If that is the case, they would need to be properly licensed and they most likely would be called what we would understand to be a financial planner—that is different.

Mr Haintz—I would like to add to that and harp on Jo-Anne's point that it is effectively impossible to put your client first, to listen to their goals, their needs, their objectives and their are 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.

CHAIR—Hindsight is always a wonderful thing. You can always look back and say, ' If only they knew what might come around the corner.' As I said to previous witnesses, the information was there in relation to a number of failed MISs where it was clear in their annual reports and in their financial statements that they were saying themselves that they were not financially viable unless they could continue to sell more of the scheme. How would that work for a professional adviser or even an accountant giving advice to someone? I am making a distinction here between just giving advice on getting an upfront tax deduction, which is really good today, and the long-term viability of the scheme itself as an investment.

Mr Haintz—I am not sure of the report you are referring to but we need to differentiate between the annual reports of listed or previously listed corporate entities and the reports of the managed investment scheme projects themselves. We also need to understand that the companies we are here to talk about here today primarily—Great Southern and Timbercorp—have been around for quite some time. There are a number of grower investors in those companies who have been in there from the mid-1990s to the early 2000s and there certainly have not been reports from those timeframes that these companies in these projects were not viable. I probably also need to put on record the fact that in the last month ASIC have asked me to provide some independent advice to them in relation to the investor profile, the types of people who should and should not be going into these projects, which I think is the point you are coming to, Chair.

CHAIR—You made an interesting point before about providing good advice versus providing bad advice, which is what this all relates to. Is it good advice to recommend somebody into a particular scheme if that scheme is already showing signs of distress—as was clear not so long ago with the two failed schemes, Great Southern and Timbercorp. You said you had confidence because everyone was working under a licensing arrangement, there was controlled by ASIC and by the ATO, that these were all ticked off as legitimate schemes and therefore there was no concern.

Mr Haintz—The reports you are referring to have probably come out in the last six to 12 months. It was quite obvious from the share price of Great Southern and the share price of Timbercorp that the companies were in real strife. I think your question is relating to if someone were to invest in one of these projects in the relatively recent past, as opposed to perhaps the late 1990s or the early 2000s.

Ms Bloch—The point David is making there is that a number of our investors have been investing in these schemes were something like 17 years and have been very supportive of the sorts of arrangements. Because they are diversified portfolio with potentially no more than 10

per cent, the people who want invest in them were looking at specific returns or issues, benefits or tax deductibility, or whatever, and would understand the long-term nature of these sorts of schemes and would not have a massive exposure. I think what you are getting to and what David has reiterated is that recently you may not have recommended these schemes but these schemes have been in place for some time. In fact, there are still many successful, viable, managed investment schemes operating today.

CHAIR—The sheer fact that they are approved by ASIC in the sense that they have a licence to operate and the ATO give them a product ruling and therefore they have an allowable deduction does not, in itself, mean anything in terms of the scheme.

Mr Haintz—From a commercial viability perspective, absolutely not. Throw on top of that independent research, throw on top of that that some time ago ASIC moved to not allow any projections to be put in place for any project that went longer than 10 years, and so what these companies were doing was getting independent experts such as PricewaterhouseCoopers to come out with the greater-than-10-year forecast themselves. The point I am trying to make is that there was a lot of information for advisers to rely on. Picking up Joanne's point, it would be very rare, if we look at agribusiness as a sub-asset class and pull up to a higher level of the asset classes available such as global shares, Australian shares, fixed interest or cash, alternative investments would be an asset class and agribusiness would be a sub-asset class within alternative investments. The view we would take is that alternative investments should not make up more than, say, 15 per cent of a portfolio. If you look at the industry fund reports as an example, you see that alternative assets would include infrastructure—

CHAIR—Sorry to cut you off, but whether they make up 10 per cent or 100 per cent, if it is a bad investment you are going to lose your money.

Mr Haintz—Sure.

CHAIR—Regardless of how much money you put in, you are still going to lose your money. That in itself does not quantify it by saying that it was a bad investment but it was only 10 per cent. If it is a bad investment, it is bad regardless of how much you put in.

Mr Haintz—The point I am coming to is that, one of the few things we can do as advisers, once we build a portfolio, is to look at diversification. A diversified portfolio may, unfortunately, include Babcock and Brown or Allco as well, but if it is only representing—

CHAIR—Not after its position has been declared. You would not advise people to invest on those companies when they are on the way down, when they are crashing, and you have the information.

Mr Haintz—No.

CHAIR—That is the point of my question: good advice is good advice, regardless of the percentage of your portfolio, but had people turned to advisers, to actual reports and looked at the history, they may have realised that a lot of these schemes were in trouble. Just because a scheme has been around for 17 years—the figure you have used—did the returns match the

expectations or the projections or, at any time, did what the schemes were claiming to be the returns match with the actual returns?

Mr Haintz—One of the problems is that because they are long-term projects, and in the case of timber

, if we focus on that for a moment, you have the planting of a tree, the harvesting of a tree—

CHAIR—I understand all the long-term stuff.

Mr Haintz—It is very difficult—

CHAIR—No, it is not difficult. You have 17 years worth of history. In 17 years surely you could work out—I am not an adviser but I ask people who are, and professionals—that these schemes do or do not or this particular company does or does not. It is not just a case of diversifying your risk away.

Mr Haintz—Sure. Some of those schemes had track records of a clear fall and a return to growers and some of the companies we are talking about today and other managed investment scheme companies have good track re4cord and get good results.

CHAIR—So what was the problem? Why did they collapse?

Mr Haintz—What has collapsed at this point in time is not the schemes themselves but the corporate entities and there is some hope—

CHAIR—Sure, but what has collapsed is the scheme itself. The investors are left with no scheme as such. They are not left with any value in their scheme. The trees are still there, the land is still there and that will always be there but they are left with no investment and no return; they are left with debt. So what went wrong?

Mr Haintz—In the case of Timbercorp, we have a case in the courts this morning with KordaMentha where they are trying to wind up a couple of the schemes. In the case of the timber, there are three potential, viable possibilities for these schemes to continue with a replaced responsible entity and if the schemes are wound up because that does not work it has been reported from KordaMentha that there are more than 30 interested parties in a non-MIS situation where the growers may get some money back. I am trying to make the point that all is not necessarily lost from a grower perspective. Granted it is not looking fantastic but what has failed here is the corporate entity themselves.

CHAIR—And why have they failed?

Mr Haintz—There is probably a range of factors.

CHAIR—Tell me what they are. We are asking the question while we have you here. You are the experts. You tell us what you think went wrong so that we can understand it. We may have views and we want to hear your views.

Mr Haintz—A bunch of factors—the global financial crisis, the ability to refinance debt, the ability to refinance debt when they have lent money to non-conforming loans. In other words, any investor could get a tree loan with Great Southern or a tree loan with Timbercorp and then when they are trying to securitise their loan book with a third-party institution, they do not want to know about non-conforming loans in this current environment. That is what has caused the debt to blow out and the debt not to be refinanced.

CHAIR—Wasn't that even disregarding the global financial crisis, because obviously there are, as you have just said, schemes still going? What is the difference between the good schemes and the bad schemes?

Mr Haintz—That is a great question. The difference is that the good schemes are not lending money to anybody on a non-conforming basis. They are actually checking that they are a viable prospect that has the capability to pay back that loan. Based on the information that needs to be provided to get that loan, in some cases they are getting knocked back—

CHAIR—Having the knowledge of all of that, as you seem to have, then how could anyone give advice for someone to get involved in a scheme such as that that has all those associated risks and problems? Again you are making a distinction between the good schemes and the bad schemes, but it appears that the bad schemes—the ones that collapsed—attracted the most money. They are the ones that attracted the highest number of investors and the largest amounts of money. How is it possible that the advice industry—accountants and advisers—could be channelling the most people and the most money into the ones that were the riskiest, which have now failed?

Mr Haintz—I think the point that I am making and the point you are making are the same points. Maybe they attracted the most money because they were easier to get a loan with and therefore the people who were advising on going into those schemes were able to get anybody arranged for finance.

CHAIR—Doesn't that just jump over the initial problem? If the scheme is good, regardless of everything else the scheme is still good. It appears to me that the scheme was bad so how could someone advise someone to enter that scheme? Aren't they looking, checking, reading annual reports, going through historical data and saying that this is a good investment because, first, you get a tax deduction and, second, it will have returns in the long term?

Mr Haintz—Coming back to Jo-Anne's point in our opening statement, our view is that there are very few financial planners involved in this. What we need to address as part of this process is the single licence, single product issue that enabled Timbercorp and Great Southern to authorise anyone after a two-, three- or five-day course to be able to sell their product.

Ms Bloch—To take a professional financial planner who has a client in front of them, as you suggest there were a number of reasons for entering into these sorts of arrangements—tax deductibility, diversification of investment and so forth—so to say that they were bad schemes now—

CHAIR—I am just using that in terms of making the differentiation. I am not trying to determine that as a definition. I am just using the words that you are using.

Ms Bloch—And we use the word colloquially, but to say that you should have known that these had all sorts of issues and so on is evident now but when financial planners would have been advising the schemes they would have done their due diligence and looked at the issues. There would have been a number of reasons for investing in them. Our members have told us that there were robust controls, they had read the reports, they had independent research and they did appear at the time to be good investments—good investments under an alternative asset class framework, so you would not put all your money in there—

CHAIR—It just seems to not fit with what actually happened in practice because we actually now know that there was hard evidence through reports of the financial difficulties and after some of these were technically insolvent and going out of business they continued being sold.

Ms Bloch—But how long back was that? I do not think that was more than 18 months back from what we understand. I do not know anyone who has been recommending these products in the last six to 12—

CHAIR—Right up till the death knell.

Ms Bloch—Really?

CHAIR—In fact, right up to the very last minute there were people still plugging them away.

Ms Bloch—Okay. There might have been investors requiring to make contributions as you are required to do.

CHAIR—No, new—anyway, that is fine.

Mr ROBERT—You indicated in your opening comment that the market is not clear. You recommended—and I hope I have got your words correct—that there be separation between product advisers and financial planners. Can you elaborate on what you are recommending to the committee there?

Ms Bloch—There are roughly 45,000 people in Australia who are authorised representatives of a licensee. They are, therefore, able to operate in financial services. Of those we think 15,000 to 16,000 are financial planners. The role of a financial planner is very different to an authorised representative in the very generic sense of the word. What we are seeing here and we have seen in other examples is that, where you have a licensee with a single authorised representative promoting a single product being called an 'authorised representative', you may have an outcome where the client thinks they are getting advice but in fact they are being recommended a product.

We believe that the term 'financial product advisor' is too broad. The market, the consuming community, is not aware of the different types of intermediaries that exist out there under the guise of licensing—they are legitimate, they are legal, they are not illegal, but they do perform different roles. In some cases, as you suggest, they sell products. In some cases they provide broking services. In some cases they provide financial planning advice. Our area of interest of course is financial planning and all too often we are responding to and taking the blame for, if you like, the entire range of product advisers which are named in the Corporations Act. That is

the problem. So we would like greater clarity of the difference between a financial planner, who has a very different role to the plethora of other sorts of authorised representatives out there who can do different things.

Mr ROBERT—Considering you have just named yourself as the veritable whipping boy—

Ms Bloch—Not by choice.

Mr ROBERT—and you would like some greater clarity, what would you like? In a perfect world what would you like the relevant act to actually say?

Ms Bloch—We would like the term 'financial planner' and even potentially 'financial adviser' enshrined in law with appropriate minimum competency requirements higher than RG146 with appropriate professional obligations. Clearly, we would like everyone to be a member of a professional association—not necessarily the FPA, I hasten to add—that is accredited by ASIC and that has appropriate entry, ongoing compliance and disciplinary actions should one of the members breach that. So a clear definition of the term 'financial planner/financial adviser' as opposed to financial product advisor, authorised representative or whatever else with much higher than the current entry and exit requirements coupled with professional obligation which is the ethics integrity piece that I have said before is impossible to regulate but is absolutely inherent in the profession.

Mr ROBERT—What do you see is the difference between a financial planner and a financial adviser? You have used those two terms independently.

Ms Bloch—Those terms are used interchangeably. Strictly speaking, a financial planner is someone who looks at strategy and has a range of different options. A financial adviser tends to be more of a transaction based person, but there is a lot a debate. We do not have ownership of those terms. There is nothing enshrined either way. What we would say is that it does not really matter whether it is a financial planner/adviser so long as the underpinning criteria and regulatory requirements put those people at a higher level of competence, qualification and commitment than the rest of the population that might be selling product, that might be providing intermediary services or so on. The terms are interchangeable. We do not have a problem with that. We have a problem with those two terms applying to an enormous population which is not differentiated in terms of its specific roles.

Mr ROBERT—Does the FPA have a view as to whether those two terms should both be enshrined in legislation or only one?

Ms Bloch—We would prefer the term 'financial planner' be enshrined but I probably have a few members and a few other associations that would have some concerns with that none the least of which would be that from a consumer point of view they do not necessarily see the difference. We would prefer the term 'financial planner', there is no doubt about that, but we would be open to the two terms so long as it was clear that there was a higher level of commitment and competence and so on in relation to the rest of the population.

Mr ROBERT—Having said that, what is your recommendation on where authorised representatives of a licensee or financial product advisers sit in the food chain?

Ms Bloch—They are part of the problem. It is not necessarily a personal issue but because 'authorised representative' is a very generic term and applies to a whole range of people. The good thing about authorised representatives on the other hand is that they are under the watch, if you like, of an Australian financial services licence and that is how regulation works in Australia. The key focus from ASIC's point of view is on the corporate entity or the licence. The licensee then has the responsibility to authorise its staff, financial planners, product providers or whatever it has, to give certain types of advice and services based on minimum levels of competency and so forth. At the moment it is the role of the licensee to determine who does what under the banner of authorised representative. Authorised representative is a bit of a catch-all. You are authorised under my licence to do certain things. You may be authorised to do fully fledged financial planning; you may be authorised to promote a product. It is the level of obligation that we understand, but it is the term that causes confusion and is very non-specific and that is the issue for us. We would like greater delineation of that term. That is not to say we would like to remove the role of the licensee and its relationship with the representatives; we just want much greater clarity.

Mr ROBERT—So do you believe that financial product advisers and authorised reps have a role in our financial services industry?

Ms Bloch—Absolutely. There is no doubt that there is a role for all sorts of different intermediaries in financial services. It would be foolish to suggest that every intermediary would have to meet with the high minimum standards of a financial planner, for example. Not everyone wants fully-fledged financial advice. What is important, though, is that the consumer understands the difference and that the person delivering the service keeps within the boundaries of what they are authorised to deliver.

Mr ROBERT—The Corporations Act currently requires a responsible entity to have, I think, three months operating capital and probably 10 per cent of the asset base. I do not quite know the numbers, but it specifies what requirement of capital a responsible entity is meant to have. Considering some of the dramatic failures we are looking at, which are corporate entity failures—corporations have failed—is the amount required of responsible entities as enshrined in law appropriate?

Ms Bloch—That is an interesting question. I do not have a view on that, but Mr Haintz might.

Mr Haintz—It is not necessarily our area of expertise. At the same time, I think that what will hopefully come out over the next six months is the need for impartiality and independence between the corporate entity itself and the responsible entity. In the case of, say, Timbercorp at the moment, you have KordaMentha, who were in a very compromised position, acting on behalf of the banks and the growers at the same time because they have taken over that responsible entity.

Mr ROBERT—In your opening statement, Ms Bloch, you indicated that this is not an advisers' problem; this is a failure of a corporate entity. There is no question at all that the corporate entities have failed. However, if I look through the history of Great Southern, I notice that they underwent a range of changes in the last three or four years. Before people would invest in a plot of dirt and have ownership, the responsible entity held full funds to make sure that plot of dirt would continue. A number of years ago, I believe, with the change of the CEO,

that responsible entity no longer kept holding 100 per cent of farmers to finish that project. Most of the funds were pulled out from the responsible entity—or, in simple terms, out of that plot's bank account—and used to cross-securitise as Great Southern moved into cattle products everywhere else. Great Southern then moved away from a straight tree business into olive groves, cattle properties and everything else. At the same time, they moved away from beneficial ownership in lots to share changes—three quite substantial and fundamental changes to a business model and, there is no question, at a business level. What were your advisers saying to clients when those fundamental changes were occurring in how Great Southern operated its business?

Mr Haintz—Taking those points in some order—and please refresh my memory if I do not respond to everything—more recently, the recommendation by Great Southern to essentially swap units in a managed investment scheme for shares was, I think, something that was reluctantly accepted by a number of people because of the way it was presented by Great Southern. Clearly those people who may or may not have got a return on their managed investment scheme have got nothing on their shares. That was the third part of your question—if you could just remind me of the second?

Mr ROBERT—The first part was the responsible entity holding the funds to complete the project, so if it all failed that lot could still continue. But they moved away from holding those funds to allow cross-securitisation to widen and expand their business.

Mr Haintz—As I said a few moments ago, I think that is a perfect example of why we need the corporate entity and the RE to be unrelated and independent. Going forward, I certainly hope we will see that.

Mr ROBERT—On that, the question was: what were your members doing when that fundamental change to business practice occurred?

Mr Haintz—Ms Bloch could probably speak from a membership perspective. My understanding is that our members represent a relatively small portion of the advised business in Timbercorp and Great Southern. Clearly some members still chose to support those products in the recent past.

Mr ROBERT—The second question was: to grow rapidly Great Southern—I am just using them as an example—moved away from what was ostensibly the core business of trees with lot ownership and the responsible entity holding the funds to complete that project. They rapidly moved sideways into agribusiness, some would argue because the rest of the world understands agribusiness in a wider context and share ownership and does not quite get trees and lot ownership. As they rapidly moved sideways into olive groves and cattle, representing another fundamental shift, again what were your advisers saying to clients?

Mr Haintz—I go back to Mr Chairman's comment a few moments ago that the balance sheet of Great Southern changed dramatically from circa 2004-05 until the more recent balance sheet when they were a trading entity when debt blew out to a dramatically higher level over the last few years. Again, I can only respond by saying that our membership supported Great Southern and Timbercorp in a relatively nominal way compared to the single licence/single product advisers. So, clearly, there were some people still charged to support those projects.

Mr ROBERT—I am referring to Ms Bloch's comment that it was not an adviser problem; it was a failure of the corporate entity. There is no question that it was a failure of the corporate entity. I guess I am just trying to understand. Great Southern went through some fundamental changes in its business model and business practice—and they were not small; they were absolutely fundamental—that were patently evident on the balance sheet, and I am just trying to get an understanding of what the industry was then saying. Was the industry saying, 'These are significant changes?'

Ms Bloch—Again, from an FPA point of our view, our concern is in relation to the advice, not necessarily into the type or distribution of information, which is the responsibility of the licensee.

Mr ROBERT—Absolutely.

Ms Bloch—But what I can anticipate is that members, research houses and licensees would have been looking at the information very closely. Bearing in mind that some of these investments were liquid, you could not withdraw funds, but you could stop contributing, which had consequences of their own. They would have had to weigh up the options. They would have had to weigh up all the sorts of issues that were appropriate and make decisions accordingly. David suggested that in some cases they continued to support the schemes, bearing in mind there were a range of different reasons for supporting them in the first place. But can I make it very clear that the FPA does not get involved in dissemination of information.

Can I also point out—and I do not want to go into the finger pointing, 'we take no responsibility' game—that, if our members have in any breached our code of ethics or rules, we will certainly take action, and clearly our inquiries are looking into that. I mentioned that our initial thoughts are that it is not necessarily a failure of bad advice per se, but that there were a whole range of other issues—there always are.

Mr ROBERT—Ms Bloch, how many of your members were authorised representatives or resellers—forgive the term—of Great Southern, as an example?

Ms Bloch—I cannot, unfortunately, tell you that. All I can tell you is that we believe that fewer than half of our corporate members—our licensee members—had some exposure to Great Southern through their authorised representatives. The actual number of bodies, individual financial planners, is hard to quantify unless we did this enormous piece of research and looked at that. From our point of view, our compliance obligations start at the licensee level. That is why we are investigating or discussing with our licensees what the exposure is. So I can only tell you from a corporate point of view what that exposure might be.

Mr ROBERT—Are you happy to provide the results of your investigations to the committee?

Ms Bloch—Yes, I am. I think we alluded to it in our report, but I am certainly happy to provide it in more detail.

Mr ROBERT—I am not sure if you have finished your internal inquiry. If you are happy to provide it, when do you expect your inquiry to be completed?

Ms Bloch—There are two pieces. There is a piece of research that we did in terms of exposure—portfolio exposure and so forth. I can give you that information today. In terms of our other inquiries, that is a much longer process because you are asking questions and within our disciplinary regulations or our constitution, we have a certain number of days and so on. So that might take a little bit of time. Unfortunately, we do not make public any of those results until the end of the process.

I can certainly try to be more descriptive in terms of what we think some of the issues might be. One thing, for example, might be that there was a conflict of interest where a licensee or a financial planner may have had a shareholding in the business as well as promoting or recommending the product to their client. We would expect that to be fully disclosed. That is the sort of thing that we are looking at—the extent of undue influence, the extent of any conflicts and so on. I am not suggesting for any minute that we are coming to any conclusions on that, but those are the sorts of things we are looking into.

Mr ROBERT—Do you have a timeframe when you expect that report to be finalised? We will not hold you to it, but is it two months or three months?

Ms Bloch—It depends on the results of the investigation. If all our answers are suitably and adequately responded to then that could be a month. If there are issues, we continue with an investigative process that leads to other actions. Westpoint took us two years to get through with some very serious issues, as you can imagine. I am not suggesting that this is like Westpoint by any stretch, but it can take quite some time. So if you do not mind not committing me to a time, I would certainly be very happy to provide you with as much information as I can, and also in a generic sense in terms of what we think some of the issues are. We have alluded to some of those in our submission. We are a little bit further down the track. I am certainly happy to ring any alarm bells, for example, where we think there are some systemic issues. We do not have any at the moment—I can tell you that now—but if there are I am certainly happy to table that through the secretariat.

Senator BOYCE—But you are currently investigating specific individual members for potential breaches of your code relating to Great Southern and Timbercorp—is that correct?

Ms Bloch—No, we have not got to that point yet. As a result of our research we have written to a number of our licensee members requesting further information to help us determine some of the issues involved in the promotion of these schemes. It is very early stages. I said earlier in my opening statement that it is our general view at this point in time that it was not bad advice that was the issue. Our members appear to have completely worked within the rules of the licensing regime in Australia. If anything, as I alluded to a minute ago, we want to be clear about conflicts of interest, influences and issues where potentially there were influences applied outside of the licensing arrangements. But I am not talking specifically. I am generically saying that these are the sorts of things we are looking at in what I would call the 'information gathering' stage.

Senator FARRELL—My question might relate to the last issue, and you might have been alluding to it. In your submission you argue for a separation between regulation of financial planners who advise regarding a range of products and those who advise in respect of their own

product. Could you perhaps expand a bit more on that and what you are proposing in that regard?

Ms Bloch—What we are proposing is that a financial planner follows a six-step financial planning process, which is a fairly detailed process around putting the client first, strategy and a whole range of different options. That is very different from someone who has one product in the kitbag and who is promoting that product. We believe that the current regulatory regime is confusing. It refers in Corporations Law to financial product advisers. The law relates to recommendation of product, so it is understandable that we have the confusion, but we believe it is getting to the stage now when the confusion is leading to very significantly poor outcomes for consumers. So our regulatory agenda—which we are tabling, by the way, in a lot more detail with the next inquiry—is around how we would like to see the term 'financial planner' enshrined with appropriate regulatory controls and professional obligation in contrast to a person who may have a single product to offer.

Senator McLUCAS—Ms Bloch, you said that you were happy that an authorised representative is under the watch of a licensee. What happens though when an authorised representative does something that is wrong—and I know you said in a very general sense?

Ms Bloch—There are requirements under Corporations Law for that licensee to enter into what is called a 'breach notice', depending of course on the type of breach. If it breaches the law then clearly there are some fairly substantial ramifications that do need also to be reported to ASIC. If they are a member of the FPA as an individual member, clearly our professional accountability framework would step in, and the best way we find out about that usually is through a complaint or where the licensee may tell us of that. There is a regulatory regime that a licensee would follow where an authorised representative had transgressed.

Senator McLUCAS—Does that happen very much?

Ms Bloch—From an FPA point of view, we generally have around 30 or so complaints underway at any point in time. Westpoint, which is probably the most significant issue we have had to deal with, resulted in the banning, naming, shaming, fining or suspending of something like 13 individual members of the FPA. Clearly, as I said, the FPA only represents 60 per cent of the financial planning population and a far lower percentage of the authorised representative population. That might be a question you would ask of ASIC in terms of their knowledge. It does not happen as frequently as the media would certainly suggest from a financial planning or FPA point of view. In fact, we compare our members against ASIC actions. If you are not a member of the FPA, you are eight times more likely to have a problem with ASIC. So we do look at those statistics very closely and we do try and set a higher standard for our members. I cannot speak on behalf of the whole population.

Senator McLUCAS—Sure. I understand that. In terms of these two companies, how many complaints that are currently being investigated are of your members?

Ms Bloch—I understand we have received no complaints from clients in relation to any of our members.

Senator McLUCAS—Finally, I note your recommendation about commission payments and that you would like to move away to fee-for-service advice. Why, then, does your policy have such a long expiration point? Why 1 July 2012?

Ms Bloch—That is a very good question, and a number of our members are asking us the same question. Commission based advice is fairly entrenched in the financial planning industry, and there are a number of businesses, particularly those at the end of their cycle, that have always earned commissions. About 80 per cent of our members offer a fee or commission or both. So we are well down the track. But this is a significant issue for a number of businesses. It is a significant income deterrent for some businesses. It potentially may impact those businesses wishing to sell in the short term. Likewise, there are a number of clients in products where the commission structure or the remuneration structure cannot be changed because of systems or technology issues, capital gains tax issues and so on. We need a time to assess the product implications and the client applications, and to put a stake in the ground to enable businesses, clients, planners and product providers to adopt what is a very significant change, and to be ready from this day forward to implement with confidence this policy.

Senator BOYCE—Just one must question from me. One of the issues that we are going to have a look at during this inquiry is whether there needs to be more specific definition of classes of investors. What research does the FPA do into investors and their skill sets?

Ms Bloch—Sadly, unfortunately, the FPA does very little research other than in responding a couple of years ago to ASIC tightening the terms 'sophisticated investor' versus 'retail investor'. I think at the time we supported some of those changes in definition. I know, though, that ASIC have some very good research that they did a little while back on investors. I know that they are very keen on this in terms of their new Swimming Between the Flags language, if you like. Some of our licensees may have more specific research. I can certainly look to understand the differences. I can absolutely understand where you are going with this.

Senator BOYCE—I think there would be some use in having not just ASIC's research on investors but also practitioner research around investors. So any information you could provide to us would be quite useful.

Mr Haintz—Probably at this stage we have two classes of investors. We have 'investors' and we have 'sophisticated investors'. Just because somebody meets that 'sophisticated' criteria does not necessarily mean they are a sophisticated investor, obviously.

Ms Bloch—I think we are all focused on this issue.

Senator BOYCE—No. They are in a better position to lose money, though, one assumes.

Mr Haintz—Sure.

CHAIR—Thank you very much for your time.

[11.45 am]

DAVIES, Mr Roderick Michael, Private capacity

McKENZIE, Dr David Charles, Private capacity

CHAIR—Welcome. Do you want to make a short opening statement?

Mr Davies—The submission I made was mainly made with experience I had gained working for the South Australian government in their water licensing division in 2003-04. My submission is intended to encourage the committee to look closely at the processes involved in the establishment of large agricultural enterprises here in Australia. The MIS schemes built on a trend in agriculture in Australia to become part of big business. These tax driven investment schemes accelerated the involvement of corporate Australia, and if this trend is to continue then adjustments may be required in the way various governments regard these developments. My submission focuses on irrigated agriculture in western Victoria as this is an area where large MIS schemes have been established and it is a region where I have some field knowledge. I spent a couple of years working for the South Australian government over the border in the Riverland looking at ways of improving commercial soil surveying.

In western Victoria Timbercorp has been a major developer of olive and almond groves through their MISs. Timbercorp's own research, at least the analysis of researches made available through their website, shows that the olive schemes have performed well below yield expectations. Could the reason be related to poor soil surveying, leading to bad site selection and inappropriate irrigation design? I am sure that the committee is familiar with the scale of these schemes but it is worth recording here that Timbercorp are only one of the companies undertaking these schemes but that 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. This 160 gigalitres equates to 10 per cent of Victoria's Murray River water consumption for agriculture and 30 per cent of South Australia's agricultural water usage. These are therefore major natural resource developments and are very similar in scale to mining developments. The committee should consider the quality of natural resource data that was collected before these developments were constructed. I have brought illustrations with me today that show how soil variability affects the variability of crops that are planted in these schemes.

Soil is the basic resource on which all agricultural schemes ultimately depend. The mapping of soil characteristics is a well-developed science and there are many knowledgeable and experienced soil scientists here in Australia. The majority of these individuals work within government and at universities. With notable exceptions, the knowledge and experience of commercial soil surveyors in Australia is less impressive. Note that I am differentiating between soil surveyors and soil scientists. I have looked at information on Timbercorp's schemes, and this is mainly from their product disclosure statements but also from the research that is made available on their website through their independent orchard expert reports. I have found some reference to soil survey within that information. I cannot help contrasting these independent

expert reports with independent geologist reports that I am used to reading—I am a geologist by profession—in the prospectuses of mining companies for their initial public offerings, their capital raisings from shareholders. 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.

In 2003-04, the South Australian government looked to develop a code of conduct for soil survey professionals which, together with guidelines, sought to improve the quality of commercial soil surveying. We can discuss the details of this later if you wish. The main concept was to create an association to bring soil surveyors together and then focus on their professional development. The soil survey professionals would use the code as a structure for their business approach, as a way to control their relationship with their clients, and to specify elements required within reports. These requirements would serve as protection for the surveyors as there have been reports in the past of developers putting pressure on surveyors to influence the findings of their surveys.

Investors in Timbercorp schemes would have benefited if the code had been in place as soil survey reports would have included a statement about the soil survey professional's knowledge and experience. This is important as Timbercorp undertook their surveys using accredited soil surveyors but the rules in place allowed these surveyors to be accredited for work in western Victoria after a very short training period. Perhaps it is worth considering whether future large-scale agricultural developments, especially where irrigation is to be used, require environmental, economic and social impact statements, which is very much in line with what is required in the mining industry.

I suggest that analysis would be worthwhile of Timbercorp's 2000-06 olive schemes. Reports suggest that yields have been well below those anticipated—in some cases by as much as 93 per cent below anticipated yield. The committee should take a close look at the soil survey data that was collected before these schemes were put in place and try to gauge the quality of the soil survey data that has been collected and whether that data had been used appropriately for crop layout and irrigation design. The question to answer is: does poor quality soil data contribute to poor yield performance? That is, poor performance of the schemes.

The other issue that I would like to bring to the attention of the committee relates to the use of geophysical surveying as a substitute for the collection of high-quality soil information. There was very much a move in the mid-2000s to encourage the use of soil connectivity measurements as a replacement for soil pitting. I brought some examples today to demonstrate that this is not an appropriate thing to push. I have also brought copies of South Australia's code and guidelines that I can leave with the committee.

CHAIR—Thank you. After some brief remarks, we will go to a few questions.

Dr McKenzie—As mentioned, I am appearing today as a private individual. The critical comments in my written submission are entirely my own. I want to try and steer away from negatives as much as possible. My main focus is to put forward some positive ideas for the future. They are based partially on the following interests that I have. You need to know that I have my own soil consulting business. It was established in 1996. My main client at the moment is an MIS company, TFS—Tropical Forestry Services—up at Kununurra. I am also chairman of

the accreditation board of Certified Professional Soil Scientists, CPSS, within the Australian Society of Soil Science. It is a voluntary position. I am happy to answer any questions about those linkages.

Before putting forward my ideas for the future, I would like to give you some important details about one more MIS disaster story that you may not be aware of. It involves irrigated paulownia trees near Forbes in New South Wales. This information was supplied to me by a soil consulting colleague, Dr Pat Hulme from Sustainable Soils Management in Warren. I have the information and could lodge it with you.

CHAIR—If you could table that, that would be satisfactory. Thank you.

Dr McKenzie—In a nutshell, a product disclosure statement, a PDS, was put out by the paulownia company. They hired a so-called expert who was actually a forester. He described the soils as being eminently suitable for paulownia trees, but a follow-up soil survey by Pat Hulme and his company discovered severe problems with the soil condition. It was very saline and sodic—just totally unsuitable for paulownia production.

Pat and his colleagues were pressured to provide the answers wanted by the managers and their investors, but they refused to do so. Soon afterwards, the trees died because of the poor soil, the paulownia company went into receivership, and Pat Hulme, a very reputable soil scientist, was left high and dry and owed a substantial amount of money. The unfortunate thing about this debacle is that the problems were avoidable. If an accredited soil scientist had been involved in the early planning stages, a lot could have been done to minimise the risk and the project could have been steered on to better country, which does exist in the Forbes district.

So what can be done in the future? Just for a moment I will put on my CPSS chairman's hat. I recommend the CPSS scheme to you. We have lots of material about the scheme. It is summarised in the brochure, which I will table. Basically, we have a code of conduct. The bar is being set higher and higher over time regarding minimum qualifications, and there is a whole lot of internal review. Some of us get together and write book chapters. This is like the bible for soil assessment in Australia from the CSIRO. John Rasic, who I am sure you are aware of, Pat Hulme and I co-authored one of the chapters in here. That has generated vigorous debate within our profession but within the soil science society and within CPSS we have the mechanism for talking to each other and resolving problems. There are even some grey-bearded elders in the background who come in—

CHAIR—So what is your suggestion, Dr McKenzie? Are you making a recommendation? What is your suggestion in terms of what you do?

Dr McKenzie—I will come to an my recommendation in just a moment. My final point is about 30 seconds away.

CHAIR—Okay, sure.

Dr McKenzie—We have a mechanism for internal debate. We have conferences about soil survey methodology. All the material is there. Basically we are very keen to develop stronger

links in the future with agribusiness. We would like to see CPSS enshrined in corporate legislation.

Just looking at the broader picture for a moment from a personal point of view—and this brings me to my final point—Australia badly needs an overarching agency, such as a bureau of soil assessment and management, linked in with nationally coordinated soil science management training to improve linkages between soil scientists and agribusiness. That is something to aim for. If there was one little thing that could come out of this inquiry from my point of view it would be: is it possible to ASIC to have a senior soil scientist on staff, someone who can look at the PDS documents coming through and make sure that there is a proper review process, because clearly the quality of that information is quite dismal from a soil science point of view?

CHAIR—Just so you understand, Dr McKenzie, ASIC does not review any of the PDSs or any of the information contained within. It is not a reviewing or authorising body.

Dr McKenzie—Excuse my ignorance about the framework nationally for corporate legislation.

CHAIR—That is all right.

Dr McKenzie—But if someone can come forward with mechanisms, my group would love to talk to such people about the possibilities.

CHAIR—I understand. Thanks to both of you. The obvious question would be: how independent and qualified are the people who write these reports for the particular schemes? Can you answer that in a general context and then for particular examples such as Great Southern and Timbercorp. How qualified and how independent are they? What is the price of the information they are providing, apart from what you have already told us?

Mr Davies—You could answer that in several ways. It would depend on the individual survey. These surveyors operate for soil traders. They are also operate within groups of surveyors who might work for contracting companies. The pressure that is brought to bear on a soil surveyor when he goes out to do a significant job for, say, an individual vineyard or an olive grove would differ somewhat perhaps to when he goes out does a job for a large agricultural scheme where the number of dollars involved is much, much greater.

CHAIR—What pressure would that be? What would the pressure be to do?

Mr Davies—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. It is that type of—

CHAIR—Is that commonplace?

Mr Davies—In the two or three years I was involved in South Australia I heard a number of those comments made.

CHAIR—So how much could people rely on those very important soil tests and other reports that determine the viability of a particular plot of land for a scheme?

Mr Davies—The critical thing is the experience and knowledge of the surveyor.

CHAIR—But how would an investor know; how would an adviser know? If somebody is going to advise on a scheme, you would expect that they would at least read the PDS. How would they know all this information?

Mr Davies—They would not. 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. Similarly, the orchard expert needs to be identified, and their experience.

CHAIR—No-one would really have access to that sort of information; it is just so in depth. An investor certainly would not know, and an adviser might not know either.

Mr Davies—If an adviser is presented with a simple description of someone's experience and qualifications and then relevant experience—so, specific to the type of soil that that development is being worked on—then at least the adviser would have some feel for whether the surveyor and the expert—

CHAIR—Wouldn't it be adviser just take it as read? 'There's the independent report, so-called. There's the report. I just take it as read. That's what it says and that's what it is. I'm not a soil scientist; how would I know? If that's what the soil scientist says then I accept it.'

Mr Davies—But unless they are a soil surveyor or a soil scientist—

CHAIR—Either or both, whoever writes the reports.

Mr Davies—That is why you need the statement in the report to explain who they are and where they come from and what they know. Without that disclosure, the adviser has got no idea at all.

CHAIR—Dr McKenzie, you referred earlier to crops, trees or whatever they might be that have failed due to poor soil or the wrong conditions or the wrong location. How do they compare with what was presented in the independent reports on their suitability and viability?

Dr McKenzie—The independent report that I saw for the example that I just gave was basically carried out by someone with no proven expertise in soil science. My belief is that the company directors who put the team of experts together have a responsibility to choose the right people. It is a duty of care, due diligence—

CHAIR—But there is no requirement for them to do that now. There is no legal requirement; there is no part of the act that requires them to do that now, is there?

Dr McKenzie—I just skimmed over what is in the Corporations Law and the responsibilities of company directors—I have to do this myself in my own small business—and I believe that there is a responsibility there.

CHAIR—Okay.

Dr McKenzie—I should also point out, just to add to what Rod said, that every commercial or accredited scientist has to carry out the science really thoroughly, but there also has to be a layman's version of their work put at the front of the report—something an adviser could understand.

CHAIR—Have you got any information you could give to us on how particular crops have performed compared to what it was claimed the performance would be—for example, growth rates, yield rates, anything at all? Do you have anything like that you can share with us?

Mr Davies—Prior to coming down for the meeting today I went back and looked at some of the Timbercorp stuff—surely it is available on the web—such as their 2008 schemes, and there are some product disclosure statements for the olive and almond schemes at Robinvale. Included in that grouping of documents there are some investment adviser references—three for the olive schemes from separate groups and three for the almond schemes—and they start reviewing the yield performance and the financial performance of previous crops that Timbercorp have established and managing. They make the point that a number of those olive schemes performed up to 93 per cent below their yield—

CHAIR—In your experience, do any schemes, successful or unsuccessful, actually perform anywhere near what is claimed they are going to do in the future.

Mr Davies—I cannot answer that, because the onus—

CHAIR—I am just asking for your view or your opinion. You are an expert working in this area. Do any of them perform as promised—half? Any idea?

Mr Davies—I cannot say.

CHAIR—Okay. Dr McKenzie?

Dr McKenzie—No, I am not aware of such a study.

Mr Davies—But, with the yield information in front of you, you should go back to the original product disclosure statement—say, for the 2000 olive scheme that Timbercorp proposed—and then look at the yield performances over the last six to eight years, go back to the original, basic data that was provided and—

CHAIR—I understand how I would find it myself. I am asking others so I do not have to do it.

Dr McKenzie—It would take some time.

Senator WILLIAMS—So you are saying that one of the key errors you see through the agribusiness MISs was that there was never enough attention paid to the condition of the soil and hence the productivity was not there afterwards.

Mr Davies—I am referring again specifically to Timbercorp because that is the information I have had in front of me for the last few days. Timbercorp schemes performed well below expectations in reference to yield. I was not interested in a lot of the other parameters; I just looked at yield. Because they are so far below what they were anticipating, it would make sense to go back and look at the quality of the soil information that was collected and how that information was used to set up and manage those properties. I am aware through the experience I had in 2003-04 that the soil surveying done over a lot of these agriculture developments along the river was done by surveyors with very little experience and very little—

Senator WILLIAMS—Do you mean experience in soil science?

Mr Davies—That is correct. 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.

Senator WILLIAMS—Is it your opinion that Timbercorp went out and established their MIS, bought the water—a very scarce commodity, especially in the Murray—and as a result of not having their ground work done, literally, their soil work done, their productivity is far less than forecast?

Mr Davies—I do not know that. I think you could find out quite quickly whether that was the case because these things have a history of yield and the original information would still be available. What I am saying is that the elements are there for that type of mistake to be made. I am unaware whether they did make that mistake.

Senator WILLIAMS—When these businesses went into such areas along the Murray, do you know how much they forced up the price of water when they were in the market to purchase water? Do you have any idea?

Mr Davies—I have no idea at all. Obviously, we are in a drought situation at the moment and water prices are very high. You could say that they have been unlucky in that the establishment of these schemes and this new demand for water has coincided with low flows along the Murray. Unravelling those two perhaps would be difficult, but you guys should have a go at doing it.

Senator WILLIAMS—Surely the more trees you plant in the Murray-Darling Basin would mean less water going to run down the river; would that be true?

Mr Davies—That is true, and less water goes into groundwater as well. Again, that is a significant issue for the long-term agricultural and environmental health of Australia. That sort of environmental, economic and social impact study should be done before you spend $250 million on developments down the river or anywhere else in Australia.

Senator BOYCE—Are you suggesting that operators of agribusiness projects went shopping for a soil science report that suited their needs?

Mr Davies—Those are certainly the stories that circulate within the industry, yes.

Senator BOYCE—And you believe those stories that circulate within the industry?

Mr Davies—I have heard too many to discount them.

Senator BOYCE—In regard to the Murray-Darling area or across the industry?

Mr Davies—I can only speak from the geographic location that I am most familiar with, and that is the Murray-Darling between the Riverland and across the border into western Victoria.

Senator BOYCE—Dr McKenzie, you provided us with a copy of a survey report that certainly suggests that in relation to a project in Queensland that the operators of the scheme simply kept looking for the answer they needed to get to sell their schemes.

Dr McKenzie—Yes. The company was based in Queensland but the project was in New South Wales, around Forbes. They definitely did go shopping around. They were very unhappy with Dr Hulme's report. They found someone much less qualified who gave a favourable report. I was, in fact, brought in as the tie breaker, but my conclusions were very similar to Dr Hulme's.

Senator BOYCE—Do you know what happened after that? Did they go looking for yet another report?

Dr McKenzie—I understand that that may have occurred, but that was around the time that the trees were performing very poorly. I should point out that there was a terrible drought at the time, which sped up the process and aggravated things. But even in a very good year, or a good series of years, I think there still would have been underperformance.

Senator BOYCE—But your reports are not time specific in terms of whether a soil is suitable or not. It is 'suitable with water', so to speak.

Dr McKenzie—Yes. It comes down to a risk management exercise. You try and choose soil that can cope with the extremes of climate that we have in Australia.

Senator BOYCE—Yes. So you are both alleging fraudulent behaviour, are you?

Mr Davies—I guess we are telling you that there are stories—

Senator BOYCE—You are covered by parliamentary privilege, so you can say what you like without anyone being able to deal with it.

Senator WILLIAMS—Bill Heffernan is sitting behind you, though!

Dr McKenzie—I guess the way I would describe it is that the directors in the Paulownia company did not face up to their responsibilities as directors. The duty of care was not there.

Senator WILLIAMS—So you are saying they just went out to market a product regardless of whether the product was faulty or not?

Dr McKenzie—It would appear that the focus was on short-term finances rather than long-term finances. That was my impression from where I sat.

Senator BOYCE—Mr Davies?

Mr Davies—The stories you hear will very much tell you that, if a developer does not get the answer he needs, he will go elsewhere. Down the river, in the Riverland and across to western Victoria, in order to get an irrigation licence you have to complete a source survey. That is the regulation. But if you do not get the source survey results you anticipate then you either put pressure on the source surveyor or you go and get another source survey.

CHAIR—How widely known is that? Obviously it is known among surveyors and people involved directly, but is it known more broadly or anecdotally? Certainly it is not isolated. We have all heard of it in parts. Who has responsibility over that? What should happen?

Mr Davies—One of the major issues as I see it is that an individual source surveyor is fairly powerless. He is an individual who needs to dig X number of pits a week in order to put food on the table. So if someone puts pressure on him, or her, there is not a lot you can do about it, in one respect. The concept was to bring the source surveyors together and create a professional association that has a set of rules and regulations.

CHAIR—Surely there would be one surveyor who is prepared to stand up and report—

Mr Davies—Well, there has been—and he made a submission to you.

CHAIR—Surely there is one surveyor who is prepared to make a submission beyond us—to ASIC, say. Certainly that is very welcome. Is there any reporting of this to ASIC where people say they have been pressured to provide a false document—because that is what it would be.

Mr Davies—There have been court cases in the past—and one is occurring at the moment in regard to one of these matters.

Senator WILLIAMS—Are you talking about an area of land from, say, Renmark through to Mildura?

Mr Davies—Yes.

Senator WILLIAMS—You are not talking about down on the alluvial flats of the Murray. You are talking about the high country out of the flood area?

Mr Davies—That is right.

Senator WILLIAMS—I have driven through there a hundred times. Does that soil vary a lot or is it generally the same make-up? Is it basically a low pH soil—4 or 5—or does it very a lot as you go along the 150 kilometres of it?

Mr Davies—You would have to speak to a soil scientist. The soils that you see, the soils that are generally being irrigated through that district, are referred to as mallee soils.

Senator WILLIAMS—Yes—sandy, light soils, as we call them.

Mr Davies—Dunes, and then they go into swales. Those soils are reasonably well understood, and a lot of the rules and regulations that operate through that district concern, and a lot of the surveyors have been trained to map, that type of soil. If you take a surveyor with five days' experience, train him on mallee soils and then put him on a floodplain soil, you presume that he will recognise the difference between the two types of soils.

Senator WILLIAMS—You would presume!

Mr Davies—So you would presume, but I have heard stories of those people being trained on mallee soils but not actually being on mallee soils when the training is done because the systems are not in place to ensure that the right type of training occurs.

Senator WILLIAMS—The point I am getting at is this: Dr McKenzie, are those types of soils through there low pH or high pH—acidic or alkaline? And what is the reaction to irrigation on those soils—do they tend towards salinity or not?

Dr McKenzie—I should point out that I am not an expert on soil in mallee landscapes; I generally pass it on to colleagues when a job like this comes my way. I work further north of that area. But I can say that a lot of the country is quite alkaline—there is a lot of carbonate in the landscape—and there are problems such as issues with boron toxicity in the lower areas. I would just point out the very important distinction between CPSS-accredited soil scientists and people who have had five days' training plus a certificate to go with it—they are two very different things.

Senator McLUCAS—Can I just ask about the five days' training: do you just get a pH kit and that is it?

Dr McKenzie—I have not been through that training myself. Rod, you have probably been closer to it.

Mr Davies—Yes, in that matter it is specific to the Sunraysia irrigation district or the Mallee Catchment Management Authority, which is the new term for it. In order to perform a soil survey within that district, you need to be accredited. That accreditation is provided by a soil surveyor who is not a soil scientist—he does not have a formal background in soil science through university; he is actually a geologist. And he provides a five-day training course. Mostly they are done on mallee soils but I have heard on of occasions when they are not done on mallee soils. The trainee is taken into a paddock where soil pits have been dug and the trainee is taken through the methods of logging—it is called the ICMS soil mapping technique, and they are trained in that mapping technique on mallee soils. So after five days if they show aptitude, can

pass the tests and then pay the money they are given a certificate and are listed as a Sunraysia district accredited soil surveyor and then they are allowed to perform soil survey for the purpose of gaining a water licence.

Senator BOYCE—Does the quality of the soil affect the value of the land?

Mr Davies—Absolutely.

Senator BOYCE—How?

Mr Davies—David?

Dr McKenzie—It is a very interesting question. It is something that I talk about a lot with colleagues. I think there is, in many cases, a lack of connection between soil assessment and land valuation, and I feel that a lot of dollars need to go into resolving that.

Senator BOYCE—Sorry, a lot of—

Dr McKenzie—Well, I feel that, as a research topic, it has been neglected in the past. Within Australian soil science we need a lot more work on the topic.

Senator BOYCE—I was making an assumption that, given what you have been telling us about people going shopping to get the right answer for a soil survey, perhaps people were buying cheap land and then saying it was suitable for a use which you did not say it was suitable for. Is that a correct assumption?

Dr McKenzie—In some cases I am aware of, people have paid far too much for land that fundamentally is not suitable for the target species under consideration. In some cases, too, there are real bargains out there—undervalued land with fantastic soil that is easily managed and modified.

Senator BOYCE—So my assumption is not necessarily right.

Mr Davies—I guess an example would be a place like the Barossa. A high-value viticultural crop is grown in the central Barossa. There has been a lot of recent development around the Barossa. As long as you can label your wine as a Barossa wine it has an inherently greater value than a Riverland wine. The soils in the Riverland might be more suitable to growing that crop but the value of the land is lower. Because it is not flagged as 'Barossa', it is perceived as a lower-value product.

Senator BOYCE—So there are quite a lot of factors there?

Mr Davies—That is right.

Senator BOYCE—Thank you.

CHAIR—Thank you very much. Thank you for your time.

[12.20 pm]

CUMMINE, Mr Alan, Manager, Plantation Investment, Australian Plantation Products and Paper Industry Council

HANSARD, Mr Allan, Chief Executive Officer, National Association of Forest Industries

STANTON, Mr Richard Roger, Chief Executive Officer, Australian Plantation Products and Paper Industry Council

CHAIR—Welcome. There are some members of the media here who want to film some of the proceedings. I trust you have no objections. I invite you to make some short opening remarks if you want to add anything to your submission.

Mr Hansard—We have no objection to filming of proceedings, Mr Chair. We would like to present a joint presentation with Mr Stanton highlighting some of the main points from our submission. The Australian Plantation Products and Paper Industry Council and the National Association of Forest Industries appreciate the opportunity to appear before the Parliamentary Joint Committee on Corporations and Financial Services inquiry into agribusiness managed investment schemes. Our evidence offered today will be specifically related to forestry-based agribusiness managed investment schemes, or retail forestry schemes.

Between our two national organisations we represent all segments of Australia's large-scale forestry, wood products and paper industries: forest management, woodchip export, sawmills, veneer mills, panel board, pulp and paper manufacturing and specialty plantation products including carbon. The fact that our two organisations have come together to present a whole of industry perspective on agribusiness managed investment schemes reflects the fact that retail forestry projects are heavily woven into the commercial fabric of the forest industry and are essential for the future development of the plantation resource in Australia. Our joint submission provided to the committee generally takes a broad industry wide view in its response to the inquiry's terms of reference. We trust the committee will consider the submissions from individual companies and from significant parties with specialist knowledge in the corporate regulation of managed investment schemes to obtain specific details and commentary on all or part of the regulatory framework.

A number of the commentators have attributed the collapse of Timbercorp and Great Southern to these companies being caught up in a perfect storm, a combination of unprecedented circumstances—the ATO test case into agribusiness investments, the worst drought in a century and the worst global recession since World War II putting overwhelming financial pressure on these companies. In this respect it should also be noted that these are not the only companies in Australia or globally that have fallen under the pressure of recent unprecedented financial events. That said, we support the committee's objective of trying to understand what led to the collapse of Timbercorp and Great Southern so we can learn from these events for the future.

CHAIR—I do not want to be rude and cut you off, but if you are going to read out all of that, please don't. I am happy for you to table that and let us get into some questions so that we can

get a better understanding of what we are trying to achieve. Mr Stanton, if you have got some short opening remarks, I would welcome them.

Mr Stanton—I will just pick out one particular paragraph towards the end of the document. I would like to emphasise to the committee that there has been a major expansion of plantation forestry in recent years in Australia, and I have provided some figures that demonstrate this. Looking specifically at hardwood plantations, this is an area where managed investment schemes have tended to focus. I would say that its expansion is not entirely due to managed investment schemes, but it is a substantial portion of it. We have seen the plantation area increase from 335,000 hectares to 950,000 hectares in approximately 10 years. The reason I make that point is to state clearly that the managed investment schemes have stated their intention to establish these plantations to generate income and they have demonstrably gone out and done that.

The production of logs from these plantations has also increased dramatically in recent years. It has gone from about a million cubic metres in 2001-02 to 4.6 million in 2007-08. Cubic metres—tonnes, roughly speaking—are a significant volume of wood, and that has generated significant income. We are talking about an increase from about $58 million of income in 2001-02 to $341 million in 2007-08. What I want to emphasise is there is the major expansion that has occurred in the plantation forest industry. We certainly believe strongly that that has generated a range of environmental, economic and social benefits, particularly in rural and regional areas, so I wanted to make sure that that was understood—that the MIS forest industry is part of that overall expansion.

CHAIR—I am happy for you to table that document. Do you want to add any final remarks, Mr Hansard?

Mr Hansard—Yes. Can I leave the committee with this thought: as an industry we would like to work with the committee and with the government to get a workable solution to this issue. In our submission we have stated that we think there are some areas where we can work effectively to address some of the issues that the committee are looking at and we more than welcome proactively moving forward on that basis.

CHAIR—Can I ask you about the difference between schemes. There are obviously lots of different schemes. There are forestry and non-forestry and whole variations within those. If I could categorise it into two areas, maybe you could provide me with some advice in terms of the two broad areas. What is the difference between schemes that have predominantly a financial, corporate background and schemes that have predominantly a forestry background? Can you tell me the difference between the schemes in terms of their motivations, their drive and what creates an MIS with a focus towards either a return or towards a product?

Mr Stanton—In my view, you might actually be talking more about the companies that develop these schemes rather than the individual schemes. If you looked at two of the schemes, you might say that they looked quite similar, but the companies that are marketing them might be quite different. Certainly, we have made the point in our submission that a number of the companies that we represent are fundamentally part of the forest and wood products industry. They might operate sawmills or woodchip export plants. They might own their own plantations.

They look at the world market for wood products and paper products and they say that they can see an opportunity there to exploit, but to do that they need more investment in plantations.

There are various ways they can attract that investment into plantations. They might put their own money in, they might raise more funds on the share market, they might borrow money, they might enter into some joint venture with an institutional investor superannuation fund, or they might use the MIS mechanism to attract what we term 'retail investment'. It is our view that it is companies that are looking at the whole investment opportunity from that point of view that are most likely to be successful, but the actual schemes they market might be no different to those of any other company with any other background.

CHAIR—Generally speaking, in those two categories, what would you say was your view of the success—and you are right; I accept that all MI schemes are the same: if you plant trees, they are still trees, regardless of who owns them—of the management body, the RE, all of the other entities, the management structure between the financial background, the companies that set up that have the financial background and the companies that set up that, say, have a forestry background? How would you distinguish between the success and failure rates between those?

Mr Hansard—Just a point of clarification: it is a little bit hard to differentiate between, say, financial management companies and companies that are forestry companies. If you really have a look at the history of what has developed with retail projects, you will see that some companies started off, yes, with a financial emphasis, but over time through evolution of what they were developing they moved into vertical integration, so they became forestry companies. Some companies already were forestry companies, and they used the mechanism of MIS to increase their investment.

CHAIR—And predominantly where were Great Southern and Timbercorp, for example, in comparison to the rest of the sector?

Mr Hansard—They started off as companies with a financial emphasis, but they were moving towards becoming forestry companies.

CHAIR—When you say 'moving towards', do you mean they never really got there? They are not there now.

Mr Hansard—They were integrating into the forest industry.

CHAIR—Would you say they were integrating well or not well?

Mr Hansard—I think they were integrating in terms of their evolution. Again, this is where it needs to be kept in perspective. Timbercorp and Great Southern were at a process where they were starting to actually harvest their resource. That is where you can actually start to have a look at how they then can integrate into the broader forest industry with their products. They were obviously moving towards building those closer links with the broader industry in relation to marketing of products, further processing, value adding.

CHAIR—Those are two failed entities, and the products are still there, the trees or whatever other crops they had are still in the ground—can they be made a success? Can somebody else step into the breach now and pick them up and make them a success?

Mr Hansard—The thing about the resources they had is that the resources are growing well. They are still growing. They are in the ground, as I said. A lot of their resource was getting to the stage when you can harvest it. Harvesting is actually underway. They are getting to a stage where the companies could actually start to move into the marketing and processing of the products that they had been growing in a substantial way.

CHAIR—In your view, what went wrong with Great Southern and Timbercorp as examples? If the trees are there and they are about to harvest, and it all seems good, what went wrong?

Mr Hansard—I think a lot of people have views on that. In our submission, particularly in relation to the terms of reference that asked that question, we have really looked at what commentators have said in relation to why Timbercorp and Great Southern collapsed. As I said in my opening statement, a lot of people have been saying, 'Look, it really has been a perfect storm in relation to the circumstances.' There was the ATO inquiry into MISs.

CHAIR—We have heard lots of things about the ATO inquiry, but there is no evidence to show anywhere that there was actually any decline in investment. It is not as if there was a real decline, certainly not in those two companies that failed. If anything, they accelerated investment. So there is that excuse gone.

Mr Hansard—I think we are providing comment on the commentary. Obviously we, like everyone else, are looking at issues.

CHAIR—We actually have data, though. It is not just commentary. We actually have data which shows that investment inflows during and after that period, certainly in those schemes, were not—

Mr Cummine—Are you talking about the Treasury inquiry into non-forestry agriculture, the non-forestry MIS?

CHAIR—No, I was not talking to any of it. That is what you guys were raising. I am just asking the question. You guys are experts. You deal in this field all the time. I am trying to ask you the question: do you see, from your perspective, a market difference between MISs that have a commercial financial background and which were set up by corporate financial companies basically to make a profit and the ones that are set up by Gunns or somebody else who has a forestry background who are growing the trees for themselves or for a broader market?

Mr Stanton—I think it is important to draw the distinction between the companies and the schemes. 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.

But I would certainly say, in answer to your earlier question, that the forestry resource that has been established, including that by some of these companies, is a very good resource in most cases. Obviously, there are examples of better performance and not so good performance. A lot of it is consolidated. It is growing in country which is relatively productive and it is relatively cheap to harvest and haul in. So there is no reason why those plantations cannot down the track generate significant income and employment. We hope they will be replanted and will support processing industries.

CHAIR—You guys must have some collective knowledge and data over a number of years to demonstrate returns on and the performance of particular schemes, being any MIS, compared to what is promoted as being their future productivity or future yield or future value.

Mr Hansard—Because some of the projects are only starting to come to harvest now, it is very hard to get a lot of information in relation to post-project performance. It is starting to increase and over the next few years, as the resource comes through, we will get better information on that.

CHAIR—But there has been a whole range of schemes though. It is not as if there is no data. There must be some that have harvested. There must be some indication, as you would know, from annual growth rates, for example, as to what your expected harvest would be year on year. If they were my trees, every year I would be measuring them and reporting back to my investors and saying, 'I know how much my trees are going to produce because I have actually measured them.' As for just saying there is no data, there must be at least 17 or 20 years worth of schemes with different forms and data. Does either organisation have any view on that? Do you have any data or information?

Mr Stanton—The individual companies managing individual projects measure the trees and report back to their individual investors on the performance of their projects, and I guess it is a bit hard for us to comment on individual companies or individual projects. That was part of the reason why I quoted those broad numbers at the beginning, just to give the message that this industry is generating significant activity. That does not necessarily mean I can say that a given project or a given property or a given investor is happy with the outcome and that it has necessarily been a financial success. It is very difficult to do that. Certainly one of the key areas that we have focused on in our recommendations in our submission is how we can increase the level of information that is available in reporting on these schemes. In terms of broad industry information, we can talk about areas of plantations and we can talk about average growth rates and we can talk about volumes and the number of ships coming into port. But that does not necessarily tell you that project X has been profitable.

CHAIR—I am not asking about the profitability of project X. I am interested, and obviously the committee is too, in projected returns, projected growth and yields—the things that are promoted and marketed when selling to investors—compared to what is actually measured year on year. Are you finding through your industry that there is a difference? Is it the other way? Is it

that now they are performing better each year than was predicted and they are getting larger yields and bigger growth?

Mr Hansard—I think it again comes back to this. If you have a look at the industry, you see the industry has developed quite rapidly over the last 10 to 15 years. I think it is fair to say that there were some projects earlier on that did meet expectations; there were some that have probably overmet expectations. As the industry moves on, like with any agricultural industry, we will see an improvement in the average returns from the industry as time goes on as the industry becomes more familiar with what it is growing and how to improve it over time, just like we have seen in a lot of instances in agriculture.

CHAIR—How accurate and how independent do you think the reporting or the information that is provided to investors is in terms of individual schemes' growth rates, yields and returns? How accurate is all of that information? How independent is it?

Mr Cummine—It is done by the independent forester.

CHAIR—Who is the independent forester?

Mr Cummine—A member of the Association of Consulting Foresters of Australia, who are engaged—

CHAIR—Sorry, but is that with all schemes, so every single managed investment scheme?

Mr Cummine—The companies are required to have an independent forester who acts outside their own forestry staff and teams to basically second-guess them, if you like—to check their work and look independently at how the plantations are going. They do that before the product disclosure statement is issued, at the beginning, and the independent forester's report is embodied in the PDS. It is one of the expert reports. But then they are mostly engaged in an ongoing basis to periodically monitor and check the inventory work done by the company itself and report—

CHAIR—I have read reports that actually show something quite different: the expected growths and the projected yields were tenfold anything that had ever been achieved in Australia. How can there be that discrepancy between what is written about expected yields in so-called independent reports and actual yields, which are counter-checked against CSIRO, for example, in Australia at any time? How can there be so much difference? Have you never heard of that?

Mr Stanton—I am certainly not aware of any situations where we are talking tenfold exaggerations of growth rates. I certainly agree that there is some debate about what growth rates can be expected, particularly if we are looking—

CHAIR—The reason I ask is that it always seems to fall that the growth rates projected are multiples higher than actual and sometimes many times higher, whether it is 10, five or two times higher—whatever it might be. How do we get to a position where it seems that many schemes have projected yields and returns that are just many times higher than anything actual?

Mr Stanton—I think there are some extreme examples, but I think the vast majority are much closer to what one would consider reasonable. Another point I want to emphasise, though, is that 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 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.

CHAIR—Are they getting it wrong more often than they are getting it right?

Mr Stanton—No, I do not think they are getting it wrong more often than they are getting it right. I guess one area where there is probably more concern—

CHAIR—If they are not getting it wrong more often than they are getting it right, how do we know that? Do we have data? As a committee we need to know whether there is a general practice in the sector where the projected yields are always higher than the reality. Or is that not the case and you have evidence to demonstrate it?

Mr Cummine—We provided some evidence in our submission. One company had just harvested in 2008 its first project—its 1993 project. It had not harvested anything before then and it exceeded the growth rate and yields by 10 per cent and exceeded its projected returns to investors as well.

CHAIR—Is that commonplace? You talk about one company, but is that common?

Mr Cummine—There are not that many projects that have been harvested yet. The early blue gum project sector—

CHAIR—I understand that, but if you are growing a tree you know exactly where it is every single day. You could measure every single day if you had to. Just saying that it has not been harvested is meaningless. It is not as if you plant it and then in 15 years it is there. It has a growth pattern and an expected yield based on every single month you could measure it. So there must be knowledge, or does the sector not know this?

Mr Hansard—There is periodic assessment on growth rates and companies do that as a matter of course, but we are talking about quite a significant area of plantations. Standard commercial practice is that you might measure those trees in relation to their performance a number of times during their rotation but definitely not every year. So we can only go on available information in relation to that.

CHAIR—Do you think it is good practice, though?

Mr Hansard—Is it standard practice—

CHAIR—No, do you think it is good practice?

Mr Hansard—To measure it only—

CHAIR—No, to basically not carry that out—to not measure every year.

Mr Hansard—Most state forest agencies that manage the majority of plantations in Australia and native forests do not do it as frequently as the commercial companies do.

Mr Stanton—There are a number of key points you have to measure. You have to assess your survival after planting—that is the key, first one. You make sure that your trees are alive at a certain period after they have been planted and that they are growing. Then you monitor them on an ongoing basis, but there is not any need or any particular benefit to go and measure them repeatedly until, really, you are approaching your first harvest, which may or may not be a complete harvest. So, provided your trees are alive and growing, it does not necessarily benefit you to know every year exactly. You will be doing surveillance across your whole plantation estate for growth and health of the trees, but as long as they are growing you do not need to know exactly. The stuff that is approaching harvest is important. I think that most of the MIS companies, like various other forest managers in Australia, have a fairly similar inventory process.

I certainly agree with you that it would be useful if we had more consolidated information rather than anecdotal evidence from individual projects. That is something I think we really need to work on. I would emphasise one thing in terms of growth rates: with some of these schemes that you may be talking about, where they are growing perhaps more exotic things which have not traditionally been grown, there may be some issues about what you would expect if it had never been done before. I would have to say that the vast majority of the MIS forestry plantations are blue gum and pine—things that are grown traditionally—and we have base lines to work off. I think we need to improve the community's understanding of the success of these projects.

Mr Hansard—Following on from Mr Stanton's point, as we move further towards the harvest stage, that information will become far more assessable because that is when that information becomes crucial, particularly in relation to marketing.

CHAIR—If that is the case—I obviously accept it—how do the promoters and their PDSs make their predictions year by year? How do they determine all this? Do they make it up? I am just wondering. You are telling me one side, and I accept it, but on the other side of the ledger is: how do the MIS managers, or whatever you want to call them, determine what it is going to be from year to year? How do they determine how their product is growing? Do they not measure it every year? If you can explain that to me, that is fine. That is what I am asking for. I just need to understand how that works. I really do not understand how that works and I am getting conflicting reports.

Mr Cummine—Are you saying—

CHAIR—I am saying exactly this: as an industry and representing the forestry growers that you represent, if they only measure closer to the crop being yielded and harvesting, that is fine, but how do they go in their PDSs, in other information to the market and in promotional material make all their predictions?

Mr Cummine—They are based on the accumulated work within the forestry industry and the results.

CHAIR—They are based on the real measurements, though?

Mr Cummine—Not necessarily in their own plantations. If they are growing a particular—

CHAIR—So we should not really rely on what is in those; it is just a broad generalisation, a sweeping statement: this is what generally happens in the industry, but it is not actually the investment that you are putting your money into?

Mr Cummine—No, not necessarily. There are ranges of expected growth rates for different species, different site productivity and different—

Ms GRIERSON—Factors on droughts and other phenomena—weather phenomena et cetera? They would be averages, wouldn't they? Certainly they should be adjustable, shouldn't they?

Mr Cummine—They will have a range of what they think is going to be achieved in a particular project, but they are not allowed to actually promote that in their PDSs. They are allowed but they are discouraged because of the prospective information and the regulatory guide. They can only put out scenarios of what has been done before and what might happen. They rely upon research houses to do that work. That is as a consequence of an ASIC regulatory guide on prospective financial information. They will be relying on, for their own purposes and to come up with the sorts of things that they would expect—the sorts of returns and yields they expect to get—what is well known in the industry within those ranges and within those sites.

CHAIR—But, as Mr Hansard said, we do not have any experience because companies are only just starting to harvest now. We will know in the next three or four years, as you said. How can it be both ways? I just do not understand that.

Mr Cummine—Regarding managed investment schemes, the retail sector is relatively recent compared to state forest agencies and the industrial plantation companies that grew their own captive wood. Pine trees, for example, have been around for a very long time—a hundred or so years.

CHAIR—That is why I tried to make that distinction at the beginning, so that we know what we are talking about, between those that had been done at two different levels and those that are grown as a forestry scheme—not a scheme as such but from a forestry base rather than a financial base. Could we make some distinction there?

Mr Cummine—I do not think there is a distinction to be made.

CHAIR—None at all?

Mr Cummine—That is, your question from earlier?

CHAIR—Yes. They are all the same.

Mr Cummine—Once you get into the projects, they are all run within parameters that constrain how they are put together, how they are promoted and how they build their PDSs, and the requirements for independent expert reports and the due diligence that they must go through

in order to get the data that they put in the PDSs. Those apply whether the companies have a board of directors dominated by people from the corporate finance sector or dominated by people from the forest industry. There is a range right across the industry. Once you get into the project level and what the companies are doing in their business, there is no difference. It is really a choice of whether they are going to grow woodchips, saw logs, veneer logs, high-value cabinet timbers or whatever—they are the sorts of differences.

Mr Stanton—It is dangerous to focus too much purely on yields. Obviously it is an important point, but you might accept that you might get a lower yield from a particular property or you might say, 'If I paid less for it or if it was located closer to the port then that might be acceptable.' I accept that you still need to make your projections and try and meet those projections, but just taking simplistic growth rates can be dangerous and that is also why it can be hard to report industry-wide. We could say the average growth rate was X, but it could vary dramatically and those variations could be quite legitimate if they had been factored in and other commercial drivers made that acceptable.

Mr Hansard—As we said in our submission, we have been through a fairly severe drought in the last decade and that has made it hard to gauge the effect on growth rates. We know from agriculture—

CHAIR—Wouldn't that simply indicate the growth rate is going to be less?

Mr Hansard—In some areas it would, yes. We know from agriculture that it has had a significant effect on yields for crops and products. Because we have a 10-year crop, a longer rotation, it is harder for us to get the feedback.

CHAIR—Sure.

Ms GRIERSON—We have heard that over half of the plantation investment businesses underperformed in terms of their projections. The losses damage the industry itself. Do you think that as industry representatives you share some responsibility in that?

Mr Stanton—I certainly do not have data available that would allow me to draw that conclusion. I certainly think that the overall financial performance of our industry impacts on its ongoing credibility. There is no doubt about that. As I said in my introduction, we have quite clearly demonstrated that the forest and wood products industry is earning returns for investors and employees, but it is a competitive business. I would not shy away from that. That was the key point in our 2020 vision strategy which was adopted by the government in 1997. We made the key point that this is a competitive industry and if we are going to be successful we need to expand our plantation resource to get the scale to be competitive. That will affect the overall economics. It is a competitive industry, but it is generating income and employment, and the ultimate test is whether the investors come back and plant the second rotation.

Ms GRIERSON—In your submission, you suggest that the industry could assist ASIC by improving disclosure about the financial risk that you attach to investing in agricultural enterprises. Could you elaborate on that and tell us how you think you could assist ASIC in being more realistic about identifying and conveying the risks to investors?

Mr Cummine—ASIC's economic philosophy underneath its regulatory regime is the regulation of conduct and disclosure, which is why members of the industry said, 'Let's focus on enhancing disclosure even more.' The nature of it would be worked out with the regulators.

Ms GRIERSON—Disclosure about what?

Mr Cummine—Particularly, the disclosure of the risks that are inherent in agricultural investment and in agricultural enterprise generally. That can be made very prominent, even more so than it is. I believe that that is one of the things that ASIC recently asked the companies to do in a letter that went around not very long ago, before the end of the financial year. There is also a suggestion that the companies could enhance the amount of disclosure of how they would ensure that the funds raised are administered so that there are always funds available to carry out the contracted services—

Ms GRIERSON—To reinvest into the crops et cetera—

Mr Cummine—and how they would manage their financial affairs so that they can withstand fluctuations in the wood lot sales from year to year. Certainly we have seen the results this year; we have a graph in our submission where it was something like 40 per cent of the results for the last three or four years. It just had another major drop because of the commercial circumstances—not sovereign risk this time.

Ms GRIERSON—Are you having discussions with ASIC?

Mr Cummine—Yes, we had a meeting with ASIC only a matter of several weeks ago on these sorts of subjects. We talked about some of the things that are in that submission.

Ms GRIERSON—What do you think the projections are for those left in these schemes, and there are some schemes that are continuing on? What is your involvement in them and what do you think should be done to make sure this does not happen again in regard to the ones that are still out there? Do you have views on that and are you putting them forward? Are you trying to make sure that agriculture is a viable investment, and therefore that sort of investment keeps continuing? Agriculture has a strong presence in this country.

Mr Stanton—It has been a key focus for us to do whatever we can to try to ensure that the trees that are out there continue to be managed. I guess that tree growing has a bit of an advantage over some horticulture where they have much more immediate concerns to harvest and what have you. We are very keen to ensure that these trees continue to be managed and ultimately harvested to generate income and are then replanted.

Ms GRIERSON—Can you do your own audit of what is out there, how it is performing and how it is being cared for?

Mr Stanton—In terms of feedback from our members and the time we spend out there, we certainly have no reason to believe that there is a fundamental problem with that. The trees are out there and growing. The fundamental challenge at the moment is how to resolve the various legal issues and the financial issues associated with the projects run by Great Southern and Timbercorp. That is really in the hands of the courts and the relevant authorities. We are making

the point that the rest of the industry is continuing to manage their projects in accordance with the commitments they made to their investors and we have no reason to believe that that will not continue.

Ms GRIERSON—Can you tell us that you are being proactive in trying to assist the industry to make sure that its performance is one that will support current and future investment.

Mr Cummine—I am not quite sure what you mean by proactive.

Ms GRIERSON—Are you being proactive in engaging with the industry that you represent to make sure that their practices are best practice and that in terms of managing of those plantations they are doing the right thing? Besides all the other aspects of management, are they, on the ground, doing the right thing in terms of these crops?

Mr Stanton—Taking forest management specifically, certainly we have a strong commitment in that areas in our organisation. In terms of independent certification of good forest management, there are several schemes that do that in Australia. The vast majority of the plantation area is certified under one of these schemes—

Ms GRIERSON—So they are certified and should be accredited and they should be able to do what they are supposed to do—

Mr Stanton—to say that they are well managed. That certainly has been a key focus of our organisation, but I guess that does not necessarily guarantee that the company running them—

Ms GRIERSON—Good management practices in terms of administration and financial management—

Mr Stanton—or the individual investor is going to make the return they want. It means the trees are in the ground, they are being looked after, the soil is being protected—all of those fundamental land management and forest management issues are being covered.

Mr Hansard—Adding to what Mr Stanton said, yes, it is true that the majority of plantations in Australia are covered by independently certified plantation management schemes. These are internationally based so they take the international rigour and they apply it to what we do here in Australia. In relation to that, it should also be noted that the industry, as I said, is integrating quite effectively with plantations from retail forestry schemes, and a significant amount of investment in value-added processing and export facilities is happening or will happen in the near future. We estimate in our submission it is about $7.1 billion worth. This is all done on a commercial basis. So, again, that supports Mr Stanton's view that the trees are growing, they are of a high standard and they are supporting local communities and our domestic industry here.

Ms GRIERSON—I think we needed to know that; thank you.

Mr Cummine—The investment that is taking place in downstream processing that is reliant on the retail forestry plantations would not be taking place and would not be being planned if they did not have an expectation that the wood flow would come. They are long-term contracts, agreements, to supply that wood over—

Ms GRIERSON—I think that is important because it really does explain why—besides the tax advantages, which were a core issue—people would be confident that these would be a good investment in normal circumstances.

Mr ROBERT—This question is for anyone, gentlemen: what proportion of the MIS plantation industry do Great Southern and Timbercorp account for?

Mr Cummine—Of the retail forestry area under management, which is something like 700,000 hectares, Great Southern and Timbercorp account for something like half at the moment.

Mr ROBERT—In your opening statement you made the point that the land for use in MISs has gone up to 950,000 hectares.

Mr Stanton—That is the total hardwood plantation area—not all MIS plantations. Of the total hardwood plantation area—that 900,000 hectares—as Alan said, probably something like 600,000 hectares would be MIS hardwood. The MIS are more in hardwood.

Mr ROBERT—So 600,000 hectares would be in the MIS, basically, of which half is Great Southern's and Timbercorp's.

Mr Hansard—About 300-odd thousand. Also, to put that in a broader perspective, we are close to two million hectares of total plantation in Australia. About half of our plantation estate is managed by state forest agencies.

Mr ROBERT—Considering that half of the MIS industry just went seriously south, what does that mean for the rest of the MIS industry? It has to mean something.

Mr Cummine—It is not the projects that have gone south; it is the companies that are running it that have gone south.

Mr ROBERT—With the greatest respect, Sir, that is completely irrelevant. I am talking about the industry as a whole. Half of it is now in administration and will start to be sold off, regardless of how it got there. What does that mean for the rest of the industry?

Mr Hansard—Going back to what we were saying before, the fundamentals are sound there in relation to the resource, so—

Mr ROBERT—Can I suggest to you they are not. Without the investors' money, who is going to maintain the properties, who is going to pay for the harvesting and who is going to pay for everything else that needs to happen? That is the big question here. I accept what you are saying—that the trees are in the ground—but, left on their own, you do not really have a crop. There could be disease; there could be fire; there are maintenance issues. Somebody needs to pay for all this. It is not the case that the trees are completely separate from the management. They are interlinked. It is a massive link. They cannot be separated that simply.

Mr Stanton—I guess what we are saying to you is that 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, how they will go about harvesting it—

Mr ROBERT—Can I pose a question to you, Mr Stanton. Considering that public confidence is a little shaken—that is probably a fair statement—

Mr Cummine—Yes.

Mr ROBERT—To what degree 'a little' goes we do not know—

Mr Cummine—I think this year's results would indicate that it is a lot more than a little.

Mr ROBERT—Let's say the industry is somewhat shaken. If no-one puts any more money into the remaining MISs out there, can the other 50 per cent of the MISs actually survive, in your professional opinion?

Mr Stanton—I think the situation for different companies will vary—

Mr ROBERT—Of course.

Mr Stanton—but certainly some of them will. Some of them are operating in areas or in species where Timbercorp and Great Southern did not operate at all. But, even in the cases of the ones who are sort of integrated, if you like, with Timbercorp and Great Southern, I have every confidence that someone—I do not know how exactly it will unfold—will take over the management of those plantations. It may be some of the other MIS companies, it may be the existing investors who want to continue their investment or it may be someone else. We really cannot be sure how that is going to pan out, but I think those plantations will continue to be managed.

Mr ROBERT—History would tell us that the administrator will seek to recoup funds on behalf of creditors, so they will start to sell things off, in probably one of the most difficult environments to sell anything, from used cars to luxury boats to large blocks of land with trees on them.

Mr Cummine—I think that has to play out yet.

Mr ROBERT—I am sure.

Mr Cummine—Those decisions have not been made. There are certainly efforts to bring about a repeat of what happened in 2001, when Australian Plantation Timber had its credit facility withdrawn by the Commonwealth Bank and went into receivership. The land that the plantations were on was bought by Great Southern and the responsibility for managing the plantations was taken over by ITC. Those plantations are now being harvested. The circumstances in which those companies came to the rescue then are very different to the ones that prevail at the moment, so it is a lot harder. But somebody somewhere is going to come and buy those plantations, whether it is an international superannuation fund, a pension fund, a paper

company who sees that the plantations are only three years from harvest and it is worth while investing in them or one of the other big managed investment plantation companies. There are a range of options. We do not know which ones are going to unfold, but somebody will do it. They will not just be left in the ground and not managed.

Mr ROBERT—No—the administrator must by law comply and recoup money for the creditors. There is no question about that; the question is one of price. In a perfect world, what needs to be done to resurrect the industry, considering half of it is in trouble?

Mr Hansard—An expedient resolution to the Timbercorp-Great Southern issue so the industry can get on and do what it needs to do. Again, coming back to the fundamental—

Mr ROBERT—Can I just stop you there. With the greatest respect, Mr Hansard, what does 'an expedient resolution' mean?

Mr Hansard—As soon as possible to get a resolution so the disruption—

Mr ROBERT—My question is: what is the resolution? Three industry executives: what is the answer?

Mr Cummine—In terms of the Timbercorp and Great Southern plantations, it is to have somebody take over responsibility for managing those plantations so that the investors—

CHAIR—But wouldn't they just collapse again? Isn't the whole problem not the plantation but the management? Isn't that what we are talking about? There is nothing wrong with the trees; they do not act in any particular manner, but the people who managed them did. I think that is where Mr Robert is going. The resolution might be temporary—somebody might buy it up and make the same mistakes all over again.

Mr Hansard—We cannot predict who would take them over at this stage. That is the thing—this is all an unknown for us. All we can say is that we hope that, whatever happens, it happens quickly.

Mr Stanton—But a new investor would come in and, based on their assessment of the value of that asset and their ability to generate income from it in the future, pay the appropriate price—

Mr ROBERT—Whether it is 90 per cent or five per cent—

Mr Stanton—Yes, and that is really a financial decision. I honestly cannot tell you how it will play out.

Mr ROBERT—Back to the question: what do you think the answer is going forward? You are looking for an expedient resolution, which is the administrator selling the assets and an investor purchasing the assets and continuing trading. Is that what you mean by 'an expedient resolution'?

Mr Hansard—Yes.

Mr ROBERT—And you believe that, if that occurs expeditiously, the industry will be back on its feet. Is that your view?

Mr Hansard—Again, I think the fundamentals of the resource are very sound. Hopefully that will drive forward a resolution in an appropriate and expedient manner so that, yes, the industry can continue. I think it is interesting to note the price for export woodchips at the moment, where this resource would potentially go. The price for export woodchips has been holding up and has actually been stable through the recession, during which we have seen significant drops in the commodity prices of a range of other products, from mining right through to agriculture. That gives you a bit of a sense of the high regard international markets have for our plantation based products.

Mr ROBERT—If the industry held up so well during the global financial crisis and woodchip prices are holding up so well then, again, we ask the legitimate question: what went wrong?

Mr Stanton—That is a key issue, I guess. It is not the individual projects, growing the trees, that have got into financial difficulty; it is the companies managing a range of projects, not even all of them in forestry. The individual schemes—

CHAIR—So what went wrong with Great Southern and Timbercorp?

Mr Stanton—It is not the fundamentals of the forestry projects—

CHAIR—I understand that. It is not a trick question. I am not trying to be cute. I am just asking a simple question. We want to find out what went wrong so that we can try to fix it so that new investors coming into the ones they will pick up can actually protect their investment. There is no point in somebody picking up the trees now at 90 per cent discount only to have investors come in and then lose their money as well.

Mr Cummine—We do not have any more information than you do about what went wrong with Timbercorp and Great Southern. There has been plenty said by various commentators—

CHAIR—Do you have a view, though, as representatives of the industry wanting to protect the industry?

Mr Cummine—We do not have any more information than has been in the public domain up till now. We do not have any special inside running. There are some things not said, but all the things we have said in our submission are the things we understand.

CHAIR—Who does have an inside running? You are the industry. We are trying to find out, but if you do not know—

Mr Cummine—I would say the directors of Timbercorp and Great Southern and the administrators and receivers would be closer than anybody else to really understanding. It was said not very long ago that short-term debt refinancing was one of the things that tipped the scales right over. Had the banks been able to roll over the short-term debt refinancing for Timbercorp then Timbercorp would still have been here despite all the other things that went wrong.

Mr ROBERT—I have a follow-up question, Mr Chairman, on expeditious resolution and the issue of a fair price. With respect to trees per hectare, what is the general industry cost per hectare?

Mr Stanton—The cost of establishing trees or the value of standing trees?

Mr ROBERT—The cost of establishing trees.

Mr Cummine—If you are a farmer and can do it yourself, the rule of thumb is around $1,500 per hectare.

Mr ROBERT—What was the MIS cost?

Mr Cummine—If you engaged a consulting forester to do all the things that a managed investment scheme manager would do, it would probably cost you around $5,000 per hectare.

Mr ROBERT—It would cost about three times as much?

Mr Cummine—Yes.

Mr ROBERT—Is that standard for the industry?

Mr Cummine—That is not a managed investment scheme. If you, Stuart Robert, engaged a consulting forester to source the land, do the evaluation, arrange the seedlings, arrange the site preparation et cetera and you paid that consulting forester to do all that, including a profit for the consulting forester and their fees, the estimation that has been done for us by someone who does this work is that it would be around $5,000 per hectare.

CHAIR—So there are no economies of scale.

Mr Cummine—If on top of that you take all the compliance costs of the managed investment schemes, which they incur just to be in the business, it is more than that. The figures in the marketplace range between about $6,000 and $9,000. That is not what they put in the ground. Seventy per cent of it has to be, under the new division 394 tax arrangements.

Mr ROBERT—So if my father-in-law on the land did it, it would be $1,500. If I did it, it would be $5,000. If the MIS I am investing in did it, it would be, in broad terms, $9,000. Going back to an expeditious resolution of what a fair price for the land would be, considering all of that, is it conceivable that the fair price is going to be somewhere down around $1,500 if an investor is going to come in? Or is that not conceivable? Am I completely off the track?

Mr Stanton—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.

There was a comment from the Chair about economies of scale. There definitely are economies of scale. If anyone gives you a number—$1,500, $5,000 or $10,000—they must be making an assumption about the average size of unit they are dealing with. It is going to be much more expensive to do 10 hectares than it is to do 100 or 1,000.

Mr Hansard—I think the other thing to bear in mind is that you almost have to take it from the investor's perspective. If you are sitting in a suburb in Sydney, what would it cost you to go and grow a hectare of trees or—

CHAIR—You would not do it. That is the whole point of having MIS in the first place. We do not need to go there.

Mr Cummine—There is evidence that through the pooled mechanism of managed investment schemes they can actually get better prices than some of the local landholders. Certainly in supplying Visy, a better deal has been done through the retail forestry project than the local pine tree growers have been able to do, because the retail forestry project can do it on a scale.

Mr ROBERT—I am not going to hold you to the numbers you quoted but let us say that it is about $9,000 a hectare for the average MIS—and of course they all vary depending on crop, timber and everything else. Remember that I am an MP from the Gold Coast and we do not do trees; we do canals and boats—and the boat industry is not having a particularly good time. So let us say it is about $9,000 a hectare.

Mr Cummine—Some of the projects are less than that.

Mr ROBERT—Great; that is noted. Going forward, is the MIS industry sustainable at those levels per hectare, in your professional view, or does the MIS industry need to have a degree of introspection as to where it is going next?

Mr Cummine—We are not talking about what it costs to put the trees in the ground; we are talking about all of the costs that go with running the projects.

Mr ROBERT—Noted.

Mr Cummine—I am no better at doing this than the research houses that do the analysis, and they are saying that there is a return for investors at those levels. With the project that we used in our submission as an example—and of course very few of them have been harvested so far—there was a pre-tax return of 13.3 per cent IRR and a post-tax return of 7-point-something-or-other per cent. So it is quite possible—

Mr ROBERT—So you believe that, if a new MIS came off the ground tomorrow, it would be sustainable in the market at those levels of costs?

Mr Cummine—Yes.

Mr Stanton—But it will be subject to ongoing competitive pressure, and I say that absolutely. We represent paper manufacturers and sawmillers—people who compete in international markets—and it is a tough market. Whether you are supplying into the Australian market

competing with imports or you are exporting, it is a competitive market. It is competitive in all aspects—energy supply, fibre supply, transport costs and all of those things—and the MIS industry is no different. So, if you are considering investing, you want to be confident that your MIS manager has taken all of those costs and returns into account and is doing everything they can to constantly improve their performance. This is not some goose that laid the golden egg industry—that is, if you plant trees, you are guaranteed to make a fortune. It is a competitive—

Mr ROBERT—I note that no economist forecasts actually held water for any longer than three months over the last 12 years, and I am sure they only exist to give astrologists a good name. So I understand that. I understand that MISs are a long-term investment but, considering the fluctuations of current markets in the short term, I suggest there are significant challenges in forecasting over the long term. I get that.

Mr Hansard—Again, I think it also comes back to the nature of the investment, and this comes back to the long-term view that we have of the industry. We have a very positive view about where Australia's forest industry is going, particularly regarding where it sits in relation to international markets and what is happening with international wood product markets as well. We have a situation where we can actually grow our industry. MIS has played a key role in allowing us to grow our industry going forward. It also should be remembered—and this has been very critical for the industry but also rural and regional communities—that, through the nineties, we had 11 million hectares of native forests taken out of wood production. The investment through MIS has actually assisted in helping the timber industry re-establish itself and helping those timber communities as well. These aspects also need to be taken into account when we start to talk about how sustainable MIS is going forward.

Mr Stanton—I would make one comment about what might happen in the future or what we are looking for. I guess a point that came out of some of your evidence this morning went to the change in the taxation arrangements that has occurred and division 394, which has really only just come into effect. What we are talking about here are the old taxation arrangements, not the new ones. So one thing that I guess we have said quite clearly in our submission is that we would like a stable taxation and regulatory environment for the future so that people can continue to invest in these schemes and we can continue to generate this wood flow. We think that is fundamentally one of the key things we need in the future.

CHAIR—You have had it since the Federal Court ruling in 2007 in the certainty about deductibility. So the certainty is there, and the 70 per cent that applies to the 70 per cent of the funds going into the ground, into the trees, gives you even more certainty—certainly for investors that there money is actually going into trees and product crop and not just marketing and promotional material.

Senator WILLIAMS—Mr Stanton, in your opening address you talked about the growth in the value of the timber—the millions of dollars et cetera. Have you ever costed that against the opportunity cost of actually running what I call standard agricultural industries on that land? For example, when you plant the trees you are doing away with your beef production, your dairy, your lamb or wool or whatever. Those industries also create jobs. You have given this figure of $440 million. I think that was the last figure you stated. As I said, have you compared the opportunity costs if that country was used in food production?

Mr Stanton—I think Alan is probably in a better position to answer that than me. Certainly we have included some figures in our submission on comparative returns.

Mr Cummine—As an exercise for the previous taxation review, which was quite comprehensive in its assessment of the taxation arrangements for forestry, we undertook an exercise where we had some economic modelling done. The economic modelling looked at what would be the implications if MIS basically was stopped. That took into account the comparative economic returns from agriculture. The results are in our submission, but basically it showed that there is a net economic loss to rural and regional communities as well as the broader economy if the MIS arrangement were stopped.

Senator WILLIAMS—One of the things that has driven you along this line of course is the lack of timber today available for milling et cetera as a result of increased national parks et cetera by various state governments.

Mr Hansard—That has been one of the reasons that—

Senator WILLIAMS—We have seen in New South Wales that huge areas that have been locked up have just become havens for bushfires now. But that is obviously one of the areas that has driven your industry from the start, I suppose.

Mr Hansard—That is why we have favourably looked on MIS as an arrangement that is being able to get sufficient long-term stable investment into the industry to build our industry going forward. Otherwise, unfortunately, we would be increasingly reliant on imports of timber from foreign sources. As we are aware, some of those foreign sources do not have the high level of forest management that we have here in Australia.

CHAIR—Thank you very much. We appreciate your time and your submissions. If you have some future documents that you want to table, I would really appreciate those.

Mr Hansard—We will table our opening statement for you.

CHAIR—Thank you very much. I appreciate it.

Proceedings suspended from 1.23 pm to 2.00 pm

WETTENHALL, Mr David, Private capacity

Evidence was taken via teleconference—

CHAIR—Welcome. Would you like to comment on the capacity in which you appear before the committee today?

Mr Wettenhall—I am the principal of Plantall Forestry Consultants.

CHAIR—I now invite you to make a short introductory statement.

Mr Wettenhall—I have made a submission to the inquiry. I would like to make the following key points. Firstly, managed investment schemes have been very positive for reafforestation in Australia, for our export markets, for rural investment and for regional employment. They have made a substantial contribution to forestry research and the development of forestry technology and germ plasm—that is, the genetics of the trees that they grow. 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. I think the use of invested funds must suit the purpose of the investment. By that I am saying that upfront payments should be set aside for future management expenses.

There has been some poor advice provided to potential investors. The public disclosure statements appear to me to be generally providing adequate information but it is not being adequately considered. I cite in my submission an example—and it is only an example—drawing upon the 2008 PDS of Great Southern Ltd. 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.

I would also like to reflect upon the role of independent experts. I have acted as an independent forester to quite a few forestry managed investments schemes and therefore I have some experience. The role of the independent expert forester needs to be strengthened. The independent forester should report to an independent compliance committee or a responsible entity—in some instances I reported to the marketing manager of the schemes, which was a very uncomfortable reporting line. In the event that the independent expert is not satisfied with the responses from the company there is no clear recourse or alternative pathway for the independent expert. Perhaps ASIC could provide training for independent experts and independent foresters. That would be part of the public education process—to educate the independent experts about ASIC's expectations of them and alternatives for them. I am supportive of the Australian forest growers disclosure code for afforestation projects and would

be supportive of the development of common standards of disclosure. I think that is an excellent move in that direction.

Finally I would like to reflect on the current situation of turmoil with Timbercorp and Great Southern. It is hurting many small and medium enterprises. I live in Albany, in Western Australia, where there are contractors who are going through particular financial hardship. This is creating personal hardship for them through the loss of money and disruption to their cash flows. They all see the prospect for things to get better in the medium term, but they could do with some help to tide them over until that improvement in trading conditions comes along. But they seem to be the lost consideration in all of this. The administrators are working their way through the situation, but in the meantime some of those small businesses are going bust themselves. That is all I would like to say at this stage. Thank you.

CHAIR—Thank you very much for your opening remarks. Can I kick off by getting your views on the requirement that 70 per cent of investment revenues be invested in actual plantations rather than on fees, commissions, marketing and so forth. I have two questions in that area. Is that what happens in practice? If so, is 70 per cent enough?

Mr Wettenhall—I cannot say whether that is what happens in practice. As an independent forester I do not receive the reports of that. In fact, I have not been the independent forester for any new scheme since those provisions have been in, so I would not have received that information for the schemes for which I am currently the independent forester. It seems to me that 30 per cent for non-direct forestry expenses is quite generous. I would have thought that 70 per cent of the fees that the popular forestry MISs are charging is more than adequate to establish and manage the schemes.

CHAIR—That is fine as a response, given that you are an independent forester. Can I ask you to elaborate a little further on the issues of independent experts and advisers and the documentation that is attached to PDSs and other promotional materials. How important is it that people rely on that information to make an investment decision—or do they skip over it anyway? How accurate is that independent expert advice in terms of soil quality, in terms of the yields, in terms of long-term growth for investments over 10 years plus and all those sorts of issues?

Mr Wettenhall—The Institute of Foresters' submission goes into that a little. I certainly think that it is a very important part of the PDS—obviously as the author of some of those independent foresters reports. Clearly some of the people considering the investments have not understood those independent reports and the PDS in general where it relates to risk and uncertainty in the statements.

CHAIR—Is it a case that the investors are not understanding the reports and attached documentation or is it the advisers advising them into these schemes in the first instance who do not understand it or do not convey the information?

Mr Wettenhall—It is likely to be, as you say, the advisers. They may or may not understand it. I have seen advisers coming out very enthusiastic about some MIS products but clearly not understanding the technical details of the products that they are very enthusiastic about. The review houses do a very good quality job in reviewing the MIS and comparing them, but once

again those comparisons do not seem to be taken into account by people making investment decisions.

CHAIR—Does an inherent conflict of interest exist for somebody who works under, let us say, Great Southern, Timbercorp or other AFSLs and has a sole product advisory role under their licence, to advise on a single MIS—where, regardless of what the PDS says and regardless of any information, their sole job is to sell that product? Is there a conflict of interest in terms of how that operates—the ability for someone to advise on a single product?

Mr Wettenhall—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.

Senator FARRELL—Thank you for giving us some evidence today. In your submission you describe a system whereby the funds managed in an MIS could be held independently in escrow for the future management of the plantations. Do you think this would be best imposed legislatively or could it be done by self-regulation?

Mr Wettenhall—It would be preferable to keep it out of legislation. Once things go into legislation, it inhibits creativity of better models. There is an example of an independent forester for APT, which is a scheme which went into receivership in 2002. The projects survive. They have a mechanism whereby the responsible entity is required each year to set aside funds, at a level assessed by the independent forester, to provide for future management of the plantations. It seems to work quite well. Those projects are coming through to harvest and, in spite of the—

Senator FARRELL—Sorry to interrupt, but could you just explain where that is working.

Mr Wettenhall—APT, Australian Plantations Timber Ltd, went into receivership in 2002. There was a scheme arrangement whereby ITC Ltd became the responsible entity for the schemes that were initiated by APT. Under the projects up until 1999 the responsible entity was required to set aside the maintenance and expense funds for the future management of the plantations. The level that is required to be set aside is determined annually by the independent forester.

Senator BOYCE—Just in terms of the strengthening the role of the independent forester that you have proposed here, as I read your submission, what you are suggesting is that there should be more promotion of the role of the independent forester. Are you also suggesting that the reporting procedure for the independent forester should somehow be covered by ASIC regulation?

Mr Wettenhall—Perhaps ASIC regulation would require that the responsible entities be at arm's length from the project manager.

Senator BOYCE—Sorry—the responsible entity would be at arm's length from the project manager?

Mr Wettenhall—Yes, or it would require that at least the compliance committee be independent of the project manager.

Senator BOYCE—I understood the compliance committee had to be independent now.

Mr Wettenhall—I do not believe that is the case.

Senator BOYCE—I thought the majority of members had to be independent. Is that right? I thought it had to be at least three. Sorry, I may have misread this.

Mr Wettenhall—At the moment, the independent forester does not have to report to the compliance committee.

Senator BOYCE—Who does the independent forester currently have to report to? Or does their simply have to be one?

Mr Wettenhall—There does not even have to be an independent forester, as I understand it. Some projects have been set up without an independent forester. The responsible entity determines who I report to. That, indeed, changes. As I said, at one stage I was reporting to the marketing manager, which was a most uncomfortable position for me.

Senator BOYCE—Was the marketing manager the director?

Mr Wettenhall—He was not the director; he was an employee. It just struck me as inappropriate for the marketing manager to be the one who was determining acceptability of an independent forester's report.

Senator BOYCE—I can understand that perhaps within the operation itself there may be sufficient knowledge of forestry for the expertise of the independent forester to not be required, but perhaps the independence is a more valuable asset in some circumstances to give credibility to the exercise. Is that the case?

Mr Wettenhall—There is always the problem that the independent forester is paid by the responsible entity.

Senator BOYCE—Auditors never seem to have a problem with that!

Mr Wettenhall—Yes, exactly. It is not necessarily a problem, but as a small business I can assure you that you like to get the job back. So there is a potential compromise on your independence just because of that. Therefore, it would be a better structure if you were engaged by and reported to somebody who was at arm's length from the success of the project, I suppose.

Senator BOYCE—I am just trying to work out who that might be. You are not saying the board of the project?

Mr Wettenhall—No. I am suggesting that the compliance committee and the responsible entity should be acting in the best interests of the investors and therefore they would be a much better body for the independent experts to report to.

Senator BOYCE—And you are suggesting that this should be covered by legislation or regulation?

Mr Wettenhall—I think that that would be appropriate to be regulated, yes.

Senator BOYCE—Thank you.

CHAIR—I might just finish off with a question around the single-fee payment structure. In your submission, you claim that it was the main reason for the structural problems with Timbercorp and Great Southern. Can you elaborate a little bit on the issue of the single-fee payment structure?

Mr Wettenhall—I accept that single upfront payments are a commercial reality, because people are able to commit to a single investment but not necessarily able to commit to the annual cash flow that forestry requires. But 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—I think Timbercorp offered an annual fee option up until 2005—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.

CHAIR—In your view, is this part and parcel of the problem that exists with the collapse of both Great Southern and Timbercorp—the issue of cash flow maintenance and viability in the long-term? Did having that single upfront fee in part cause that problem?

Mr Wettenhall—I am not sufficiently familiar with the circumstances of Timbercorp and Great Southern to say that. I could not honourably say whether that was the case or not.

CHAIR—Just in general terms, do you see that that type of structure—that single upfront large, lumpy investment—may lead to problems where, if finances or cash flow become an issue later in the life of a scheme, to continue the scheme you would need to get new investors in, creating let us call it an accidental or artificial type ponzi scheme?

Mr Wettenhall—No. I would have thought that the single upfront payment, if it had been well provided for, would have helped those companies, because they would have a bank of money to strengthen the company. Each scheme should be managed in its own right with money provided for future liabilities, future expenses. But that apparently has not been happening.

CHAIR—That is 'should' and 'if', but there are no requirements that that actually take place. With a poorly managed scheme, it could be the case that they receive all the money upfront and, whatever they do with it over the next 10, 15 or 20 years is—

Mr Wettenhall—I have got to say I am not implying that Great Southern and Timbercorp were poorly managed. On the contrary, from a forestry point of view, they seem to me to have been very well managed. I am amazed that they have got into the trouble they have, except that

their new investments have collapsed. That suggests that it is something of a ponzi scheme, but I am not in a position to know whether or not that is the case.

CHAIR—That is fine. Thanks very much. Is there anything further you want to add?

Mr Wettenhall—No, thank you.

CHAIR—Thank you very much. We appreciate your time.

[2.26 pm]

ABRAHAM, Mr Anthony, Chief Executive Officer, Macquarie Agricultural Funds Management

CHAIR—Welcome. I invite you to make some opening remarks.

Mr Abraham—Firstly, I would like to thank the chair and the committee for inviting me today. Macquarie Agricultural Funds Management operates as part of the Macquarie Group. We have approximately $1 billion of funds under management or committed to be managed. We operate 3.2 million hectares and have about 150 employees working across those operations. Together with our consultants, they have expertise in pastoral operations, horticulture, grains, viticulture, forestry and dairy operations. We manage funds for Australian retail investors but also for European retail investors and for European, North American and Asian institutional investors as well. We come at agriculture with a fairly broad perspective in that regard. We look at agriculture and its investment across a number of different investor bases.

Part of our broad perspective on agriculture and its operations is also borne out by the fact that Macquarie has been involved in this business since about 1989. Today we have operations specialising in risk management to do with agriculture, funds management operations and corporate advisory businesses as well. We also have a dedicated agricultural research team with people operating out of both London and Washington. We have people involved in agriculture here in Australia and in New Zealand, North and South America, Asia and Europe. This allows us to bring a global perspective to what is happening. We bring a global perspective to agriculture and we bring that global perspective to what we are seeing here in the Australian market. That global perspective and the work that is being done by our research people and our discussions with investors all over the world is bringing home to us an increased interest in what is happening in agriculture, particularly from wholesale investors, principally offshore—the wholesale investors being pension funds and superannuation funds.

The increased interest in agriculture has been driven by the fundamentals underlining agriculture. You may well already have heard much of the story about the growth in demand in agriculture and some of the challenges that are around the supply and meeting that increase. That has been reflected in the performance of agricultural commodity prices, particularly in the last 12 months, where there has been a significant amount of market disruption. Indeed, it is the performance of those agricultural commodities and the prices that they have produced relative to the other asset classes that has highlighted the lack of correlation between the two asset classes. That lack of correlation from an investment perspective is very positive because it allows for diversification. Again, this is driving further interest from investors, particularly in the offshore areas. So we think that agriculture is an asset class. Viewed from a wider perspective it is a good asset class and one which is well worthy of consideration by investors. If we are offering it to people in the rest of the world, we think that it is particularly relevant for Australian retail investors as well.

The structures that we have used in the Australian retail agricultural funds market, which is commonly referred to as the agri managed investment scheme—and I use the term ‘the

Australian retail funds management market' purposely because what we are dealing in here is funds management at the Australian retail level—have been highly successful in attracting funds into this and providing Australian retail investors with the same access to this asset class as we are seeing not only here in Australia in the institutional world but also offshore. Macquarie operates in this space but, importantly, as we do so we operate from the perspective of a fund manager, we operate from the perspective of a global participant in the agricultural sector, and we operate as somebody who has a deep belief in the asset class.

In the Australian context, we only operate two schemes. We only operate the Macquarie Forestry Investment and the Macquarie Almond Investment. We have been offered a whole range of other things but, as I said, we approach this as a funds manager, and, as we went through our funds management disciplines and rigorous checks, these were the two areas in which we thought we could put forward an investment grade product and we stuck to those. As a result of that, these projects continue to operate, and at this time nobody has lost any money. The schemes are performing as we expected. In forestry, part of the practices is to make sure we have best practice forestry undertakings. That includes checking the inventory that we have of our forestry at age one, at age three, at age five, at age seven and at age nine. We do regular inventory checking. It is necessary so that our investors can know exactly what it is happening and how we are performing. It is important.

Our year three testing has told us that there are no particular problems with the projects that we have got in our 2003 and 2004 projects. We need to be careful. Early-year testing is not as reliable as latter-year testing, but we have been through a checkpoint and we can tell people what is happening. Funds management is about transparency. It is about providing comfort. That is all about giving people information on a regular basis, and that is what we aim to do. In addition, our forestry project provides people with access to the land on which the trees are planted, so they can invest in that as well. That also provides them with the potential benefit of any increase in the value of the underlying land. The structure that we adopted was innovative; it was new. We think it provides additional benefits but, in light of what is happening with the collapses of Timbercorp and Great Southern, we would sooner provide significant risk management. We think that that is important as well.

We have our Macquarie Almond project. We completed our first harvest this year, which was a very exciting time for us. It is interesting watching a project going from a piece of bare dirt to harvest. I am pleased to say that the harvest met the forecasts that we put in our PDS. Meeting the forecasts that go in your PDS does not happen by accident. It happens because of good management but also because the expectations that you provide to people need to be realistic. We spent a lot of time looking at that. I might mention that when we first started in forestry we told people that a hectare of land would provide about 230 tonnes of wood over a 10-year period. At the same time all the market leaders, people who had been in the market for some time, were telling people there would be 300 tonnes. The reason we picked 230 was that that was what we were actually seeing happen on the ground. We were told by many people that we must have poor ground or our practices must be poor and nobody would actually believe us when we said, 'No, this is where the expectation should be set.'

So our performance is in part due to our management but also in part due to sensible expectation on establishment. Again, I think that comes back to sound funds management practices, which can only come if you have been involved in funds management for some time,

as Macquarie has been. We believe that the way our projects are operating is evidence that a well run, properly capitalised agricultural funds management business run along funds management principles and guidelines can provide Australian investors with access to all the benefit of the Australian agricultural class. We believe it is possible to do it and to do it well.

The other thing we believe is that Australia has the opportunity to develop a market in the export of Australian agricultural funds management expertise. Australian farmers operate in pretty difficult circumstances. They have no government support, they are in a deregulated market, they have climatic conditions to deal with and we have a floating currency—really difficult things. As a result, Australian farmers have proved themselves to be resourceful, resilient and always looking for the best technology. If we can export those sorts of skills into other jurisdictions we think we can develop a business in agricultural funds management not just here in Australia but in a global context. We at Macquarie are exploring this at the moment.

When we say to people that we think we can do this offshore, they say, 'What are you doing in your home base?' In the absence of the Australian retail agricultural funds management business, we would have nothing to show them—we would not have a platform, we would not have a springboard off which we can take this. We have had offshore investors come to Australia, parties whom we have looked to work with, who have looked at our operations and are using those as a basis for judging us as we seek to take our businesses offshore.

We started our funds management business back in 2001. There was a reference just a minute ago to Australian Plantation Timber Ltd. In 2001 Australian Plantation Timber went into administration. At that time, I led the team which looked at the possibility of Macquarie acquiring Australian Plantation Timber and using that as our entry into this market. Ultimately we did not proceed. It is interesting to note that Australian Plantation Timber—which, at that time, was the largest of the managed investment schemes, the largest of the promoters in the market at that time—got into trouble. The other two leading parties at that time also got into significant financial difficulties and were fortunate to arrange refinancing which saved them from the same fate as Australian Plantation Timber.

Interestingly, eight years later we find ourselves in a similar position. The leading two operators sadly now find themselves in administration but the numbers we are dealing with are much larger now. I seem to recall that Australian Plantation Timber owed the banks $40 million. The numbers now are much larger and there are more investors impacted, more hardship caused, more difficulty and more damage done to the concept of agricultural investment. Importantly, if we do not learn this time around from the lessons of 2001 and 2009, we run the risk of continuing down the same path with the potential for additional issues into the future. For this reason and because we have the capacity to look at this broadly, given the range and depth of Macquarie's disciplines and skills in this area, we spent considerable time looking at the industries, the structures and the potential issues.

We believe that there is an important role for Australian retail agricultural funds management and this can only be delivered if we can work out how to deal with the problems and save them from coming up again. As a result of the work we have done, the key issue we have identified in what happened in 2001 and what has happened now is that, 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. If the companies are not well capitalised, if they are small companies to start with, this creates issues and the more the company does to try to get big, which is to sell more assets, the greater the funding issue it creates and the greater the issue it causes for the company.

For very large companies or for financial institutions, that is not a problem. If the structure is self-funded, so the investor pays for the underlying land and the trees on it, that is not a problem. Sadly 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.

That same theme runs through 2001 and 2009—broadly the same theme. You can draw too many parallels. So we think that this is a key issue and we think that dealing with this issue is one of the key reforms, one of the key things we should be looking at in this space. We have dealt with this and we have also looked at a couple of other reforms and they are included in our submission. I thank you for the opportunity to make an opening statement. I would be pleased to take any questions you have in relation to our submission.

CHAIR—Thank you. Can I begin by asking you what you believe is the impact of the collapse of Great Southern and Timbercorp on Macquarie funds, on your schemes? What has been the damage, the impact, the investment potential and so forth?

Mr Abraham—I should firstly state that the Macquarie projects are running well, that they are well funded within the Macquarie group and that they continue to be well run and well funded in the group. At an operational level, all the schemes we have undertaken in the past and the business we are continuing to do now is not affected. So people who are currently invested in our projects are not affected. The difficulties faced by the collapse of Great Southern or Timbercorp have had an impact on the confidence of people in the agricultural retail investment sector. So the impact we have seen is a reduction in the number of people willing to participate in that sector in the current year while they wonder what happened and have lost some degree of comfort and confidence in what is out there.

We have put ourselves out there and said that at Macquarie we are different; our structures are different; our projects are performing; it is going well; it is part of a large group and we are growing, and agricultural in Australia is part of our broader agricultural interests. Even in that context, even with those powerful messages it has been very difficult. This inquiry and the reforms we hope will come out of this inquiry, including some of the suggestions we have made, we think will be critical in rebuilding that level of confidence and trust. Fundamentally, we think that the agricultural asset class is a good asset class and fundamentally we think that that asset class should be made available to Australian retail investors.

CHAIR—Does the fact that Macquarie's structure is different from the ones you described early—when you said there are basically two types and that yours is different—minimise the

impact? You do not have a need to look for new investors to ensure the continuance of the success of your schemes. Is that a major difference?

Mr Abraham—Macquarie is a large, well-capitalised group. As a financial institution our position is very different from that of Great Southern and Timbercorp.

CHAIR—You do not need new investors at all? Once a scheme is full, you do not need to attract new investors to continue the success of that scheme. Is that right?

Mr Abraham—That is correct. In our forestry project, people invested in the land and in the trees. That project was totally self funded. In our almond project, Macquarie provided the orchard, which required us to buy the land, develop the orchard and buy the water. At the time we went into the project, we had the funds there and available. One of the difficulties with Great Southern and Timbercorp was that at the time they did their projects they did not have the capital and they relied on future equity raisings to provide the capital to buy the land or to continue to buy the water over time. When those equity raisings did not happen, it was impossible to continue to buy the water. So in Timbercorp's case, you have orchards that are not completed; they do not have the water.

At Macquarie we have the funding in place. Again as we look at the sorts of things we think should be done in order to remove the risk of this happening again, there should be some sort of certification at the time you do a project. I am going to do a project this size and I have the money to undertake it. I have the money to buy the land. I have the money to buy the water. I have the money to undertake the whole project and I will not sell more than that. If we did that, then I think we would relieve some of the major issues we have had here.

CHAIR—Is that realistic, though, in a market where you can raise funds, where you can raise better equity?

Mr Abraham—I think it is realistic and I think it is responsible as well. It is difficult to say that I am going to undertake a future obligation if I do not know today that I can certify to somebody that I have the financial wherewithal to meet the obligations that I have inherently entered into by offering somebody a horticultural project or a forestry project.

CHAIR—If there were a model like the one you are describing, what guarantees are there that, after it is approved and you have entered into the scheme and are operating the scheme, you do not further securitise the equity in that scheme and then create the debt, needing a future obligation afterwards?

Mr Abraham—One of the safeguards you can have in relation to land, which we referred to in our submission, is to create an inalienable right of access so that any party who entered into future debt arrangements with you would have to take account of the inalienable land access rights. One of the other issues we have seen is sale and leasebacks, where people actually own the land today: I invest in the project, the person owns the land, I feel very safe and comfortable but five years down the track, three years down the track or two years down the track that land is subject to a sale and leaseback. All of a sudden I do not have absolute access to the land. If we could have a requirement in there where any sale and leaseback was subject to the pre-existing

rights of the investor, which were inalienable, I think that would save people from the sort of situation you are referring to.

CHAIR—Before I go to questions from the rest of the committee, can I ask: what is the size of Macquarie MIS schemes as a percentage of the whole sector? We have heard that Great Southern and Timbercorp were about 50 per cent, all up, of the whole sector. I am just wondering what the size of Macquarie is.

Mr Abraham—Macquarie is very much a small player. We have typically been between five per cent and 10 per cent of the market and sometimes less than that. We have been in the market since 2003 and have been building over that period but we are generally a smaller player.

Senator WILLIAMS—Mr Abraham, you said in your opening address that at Macquarie you have had success in getting funds for your projects. Are you on course to return dividends to those investors?

Mr Abraham—Yes, in the—

Senator WILLIAMS—I say that because every two years you are doing a measurement of the production, the growth et cetera, of your forests; is that correct?

Mr Abraham—We are.

Senator WILLIAMS—So every two years you can bring to your investors an update of how their real investment is looking as far as a return goes?

Mr Abraham—We do that. Not only do we measure but we report to our investors the results of those measurements. We have done that over the last two years for our 2003-04 project. We will do it this year for our 2005 project. I should note that the three-year inventory cannot be taken as a guide of what is going to happen into the future but it is a checkpoint. It is information, it is transparency, it is the sort of thing you do in funds management businesses.

Senator WILLIAMS—Surely, as we look forward, that is something that all MISs should be doing—taking correct measurements and doing data audits of the progress of their plantation to keep their investors informed of how it is performing.

Mr Abraham—I agree wholeheartedly, and that is one of the things that we have suggested in our submission.

Senator WILLIAMS—Yes. I have read your submission.

Senator BOYCE—There were a number of comments earlier around the quality of the soil surveys that were presented, which underpinned a lot of these projects. What is Macquarie's assessment of the quality and credibility of what is provided?

Mr Abraham—I guess I can only comment on our projects, because I am very familiar with ours and not so familiar with those of others. In all agriculture, soil is very important. The way we go about forestry—indeed, the way we go about all of our agriculture—is to look at these

things as genuine investment projects, and that means to operate in as commercial a way as possible.

In forestry, we teamed up with Midway. Midway are a privately owned company operating out of Geelong who are Australia's second largest exporter of woodchips. They have been in the business since 1984—

Senator BOYCE—The second largest?

Mr Abraham—The second largest exporter of woodchips out of Australia to the Japanese market. They have been operating since 1984. I think they have been exporting since 1986 and in recent years have exported about a million tonnes of woodchip per annum. They have significant plantations of their own. When we started with them, we provided the structuring and the funds management capability and—

Senator BOYCE—They provided the forests.

Mr Abraham—they provided those. When we started our work and were looking for the appropriate soils and conditions to plant in and the sorts of productivity we could expect from that, we worked with Midway, who had done a lot of sampling in their own forests and had seen what growth response you got out of certain soil profiles. So we worked very closely with Midway. We then had that work verified by our independent experts at the time, Jaakko Poyry. When we work with independent experts, be it on soil or indeed in any other area, we look to get the best people we can in the area.

Senator BOYCE—So you would have done some due diligence on their ability to perform the tests that they were saying they could.

Mr Abraham—Yes, and Jaakko Poyry were—they tell me; I am not going to disagree with them—one of the world's leading forestry consultancy companies, so we worked with them in that regard. We still work with Jaakko Poyry but we also now work with Mr David Geddes, who is operating out of the Portland region. David is well regarded and has held senior positions in Australian forestry organisations. He is a really well regarded guy. In the horticultural area, we worked closely with Scholefield Robinson Horticultural Services, who are very well regarded operators in the space. I think it is interesting to note that when we work on institutional or offshore projects, we use exactly the same people. So we do look to use the best people because we regard the advice we get from them as a protection for us as well as a protection for our investors, and we continue to work with these people in an ongoing sense to make sure of the practices that we undertake. We have an annual review of what we are doing in both forestry and horticulture, and we have our foresters report to the board quarterly. It is the same with our horticultural guys as well. We have annual reviews as well.

Senator BOYCE—We were told earlier that it was generally known within the industry that some operators simply went shopping to find the report that they wanted in terms of the soil conditions. Are you aware of those rumours?

Mr Abraham—No, I am not. I am aware that when we did our business that the way we went about it was to look for the best person—the person that we felt that we could rely on.

Senator BOYCE—But you have not heard anything else about any other operator in the sector not being perhaps as diligent as they might be in getting correct reports?

Mr Abraham—In agriculture and in every single industry there are 150,000-odd stories going around about all sorts of things. Mostly they are fabrications. People like leaning over the fence, looking in and seeing things that are wrong. As to whether I have heard one about soil, I am not sure, but I have certainly heard a great many stories. I might add that it is not peculiar or particular to agriculture.

Senator BOYCE—Oh, no.

Mr Abraham—I think in most industries—

Senator BOYCE—Absolutely, but some rumours are based in fact, not simply in rumour. So it is a matter of sorting through what is what. The other question I have is around the role of the independent forester. I do not know if you were here a little earlier to hear the suggestion that that role should be beefed up and perhaps put into legislation or regulation to enforce the independence of the role and to improve the credibility of the information provided.

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.

Senator BOYCE—What would Macquarie's view be about that being a requirement rather than something that you choose to do?

Mr Abraham—It is consistent with our current practices, so we would welcome it.

Senator BOYCE—Thank you.

CHAIR—You said earlier that there were a number of lessons to be learnt from 2001 with the large scheme collapses and from similar occurrences now. Could you elaborate on what the lessons are to be learnt?

Mr Abraham—I think they are around suitable capitalisation of entities undertaking these businesses. These businesses require a lot of capital; they are very capital intensive businesses. Smaller operations or businesses that do not have the capital to undertake the business at the time they enter into the obligation get themselves on a treadmill where they are constantly chasing to get enough capital to keep the business by being more successful, requiring more capital. I think you can break that nexus, as I said before, if you have a requirement, some certification or something, that you have the initial capital to undertake a certain level of sales. If you have that level of capital you can take yourself off the treadmill and do not have to be

running faster and faster. That is one of the reforms we have proposed in our paper. For mine, that is the interesting learning from it.

CHAIR—Do your funds operate in a manner where it just requires a single fee upfront and that is it for the life of the investment, or do you require ongoing annual contributions for maintenance and so forth?

Mr Abraham—We have two different types of schemes, and they reflect the different types of undertakings. Our forestry scheme is a single upfront payment. The cash flows in forestry are negative on day one, when you plant your tree. There is no income along the way, and at the end of time there is a cash flow, which is harvest. Forestry by and large does not have significant ongoing maintenance costs. The trees are planted and there is a degree of care required over the first couple of years, while the trees are small, but once the trees reach a certain level—sorry if I am sounding like a forester, but I have picked up a bit along the way—you get canopy closure, which is where the trees join together, and weed control and the like become less important, and I have actually walked through a number of mature plantations. So there are not significant ongoing costs along the way. The profile where you have an upfront payment, with nothing along the way and deferred fees for both rental and maintenance, suits the cash flow and is consistent with the type of operation we are running.

CHAIR—That scheme, though, would require greater managerial control and proprietary in terms of managing the funds and making sure that there is some fund available to actually manage the trees beyond just the first two or three years.

Mr Abraham—It would. In our case, what do we do? We look at the costs that are to be borne over the course of the project and from our own resources we create provisions. We create provisions based on our expectation of what those costs will be over the term. That is really putting money aside, and then we will recoup that out of the harvest proceeds at the end of time. Those provisions are established upfront and they are reviewed on a regular basis by our financial division, who take a look at those and get themselves comfortable that there are sufficient funds to go through to the end of time. If necessary, we adjust the provisions to meet any requirements. Those funds are held inside Macquarie, which is a bank.

Our horticultural business is different in two regards. It is different firstly because after year 3 there is some cash flow generated from our almond trees. In year 7 they come into full maturity, so a degree of cash flow comes from that. The fees that are payable in an almond project are generally fixed in years 1, 2 and 3, and thereafter they are the actual costs of operation. The cost of running an almond orchard is far more significant than that of a forestry plantation. There is pruning and all manner of things that need to be done on those properties. It is intensive agriculture, so we do have annual fees. The first three are fixed, and thereafter they are the actual costs of operations. Again, from the perspective of an investor who is participating in these schemes, that style of fee structure works quite well, because there is the potential for annual income coming from harvests.

CHAIR—You said earlier, too, that in 2001 Macquarie looked at buying APT.

Mr Abraham—We did.

CHAIR—But you did not go ahead with it. Can you tell us why that was the case?

Mr Abraham—Somebody offered more money than us.

CHAIR—Fair enough. Thanks very much.

Mr Abraham—Thank you once again for the opportunity to present.

Proceedings suspended from 3.00 pm to 3.20 pm

NEWTON, Ms Kris Anne, Chief Executive Officer, Horticulture Australia Council

SWADDLING, Mr Stuart James, Chair, Horticulture Australia Council

CHAIR—Welcome. I invite you to make a short opening statement.

Ms Newton—I guess the critical point that we want to make is that we welcome corporate investment in horticulture. There are many benefits that that has conferred on both the industries concerned and the communities within which they operate. However, 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. There are some, shall we say, corporate governance and regulatory issues which we believe have not been particularly well dealt with in the past, and we would like to see stronger guidelines and stronger regulatory controls around some of those issues. Horticulture has been growing very rapidly over the last few years. Part of that is because of the input of managed investment schemes, some of whom are excellent operators, some of whom are probably less than excellent. We would like to see a clearer operating environment for managed investment schemes within the horticulture sector.

CHAIR—Thank you. Do you wish to add anything, Mr Swaddling?

Mr Swaddling—No. I am happy to leave it at that, thank you.

CHAIR—Your biggest point seems to be that horticulture MI schemes in particular really do not need any incentive from government, that they are in their own right successful ventures and investments, but obviously there has been some substantial growth in the sector because of the tax deductibility. What sort of impact would you see if, as you say in your submission, tax deductibility were removed? What sort of impact would that have on horticulture as an investment?

Mr Swaddling—I think it would certainly slow down some of the investment, but 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.

Ms Newton—For example, we have issues around market access on the international front for a wide variety of our horticultural products. Our domestic market, as you would be aware, is relatively small, and production in many of our industries—almonds, mangoes and many others—far exceeds what the domestic market can actually cope with. Unfortunately I think it would be fair to say that the process of gaining market access overseas can be difficult through to glacial at times, and it can take in some cases 15 or 20 years to gain market access. If any farmer or investor or industry sector starts looking for market access at the time that their production is ready to mature, they are a little behind the eight ball. What that inevitably means is that it is dumped on the domestic market, with the inevitable result that prices crash. So there are some production predictions—industry getting together to work out what the likely

production is for any given year, industry working together to seek markets overseas, to gain market access, to have all the phytosanitary arrangements in place and so on. To us, that is a much more sensible approach than someone at the last minute, at the death knell, suddenly deciding they have got all this product and saying, 'My goodness; what are we going to do with it?'

CHAIR—Is there an effective saturation level in horticulture?

Ms Newton—We have not reached it yet, as far as I am aware, but that is mostly because horticulture spent many years working on effective long-term relationships with overseas markets for the excess that we produce, which is significant by Australian standards.

CHAIR—So if saturation levels are not reached as yet you still believe there is significant demand in the international markets, let alone domestic markets—

Ms Newton—Domestic and international, yes indeed.

CHAIR—to sustain all Australian horticultural, regardless of whether it is an MIS or otherwise?

Ms Newton—Correct.

CHAIR—Has the MIS component, though, had a significant impact on those who are not involved in horticulture through MIS?

Ms Newton—There seems to be some evidence in some commodities in some communities with some resources, for example, that there have been impacts, but it is very difficult to generalise because, as you are aware, there are 180 different commodities that we produce and export, let alone the ones that we have, clearly, for the domestic market. As you will have seen from our submission, MISs are involved in a great number of those different products. It would seem that in some regions for some commodities competition for resources such as land, labour and water has been fierce. It may have raised the costs of some of those inputs for some of the more traditional farming business structures. But it is hard to generalise that, unfortunately, because there are also benefits that accrue in some commodities and some regions for some issues.

CHAIR—Is the issue more about whether or not it is an MIS, in terms of collective investment into a particular commodity, or is it the tax deductibility issue that you see as the key problem for your sector?

Ms Newton—It is a tax deductibility issue for us, because that is an artificial incentive to focus on the capital input up-front rather than to focus on the actual output in five, 10, 15, 20 years time of, usually, trees and vines. Those are the generally the ones that are the focus of MIS because they do have significant capital input costs.

CHAIR—And because they have a longer lag time?

Ms Newton—And they have a longer lag time.

CHAIR—Or lead time.

Ms Newton—Whichever way you like to put it, until production. The problems occur when the focus is so much on the actual incentive up-front from a taxation point of view that they lose sight of what they are going to do with this productivity when the lead time is up.

Senator McLUCAS—I just want to pursue that question of whether it is a market distortion. In the submission from the forest industry, they refer to the Australian Agribusiness Group's research around land prices. I do not know if you have read that particular part of the submission. I note what you have said to the chair, but do you have any comments on the assertion that some have that the involvement of MIS in various regions does in fact increase land prices?

Ms Newton—As I said, our industry has conducted some research, and it would appear that in some regions for some commodities that may well be the case, but it is difficult to generalise because not all regions and not all commodities are necessarily that demonstrable. I can only, obviously, comment on behalf of horticulture, not on behalf of forestry.

Senator McLUCAS—Of course. Is the research that you have undertaken something you could share with the committee?

Ms Newton—It is a public document. It is actually undertaken jointly between the Agricultural Investment Managers Australia and Horticulture Australia Limited. We do refer to it in the submission, but I can get you a copy of that if you would like.

Senator McLUCAS—I am sure we can locate it. The other question is around commodity prices, and I think the answer is probably the same. Is that particularly a problem in areas which are fairly reliant on one commodity—I am thinking of sugar cane or mangoes—and in markets where the product is very seasonal and is not exported?

Ms Newton—I am struggling to think of one with the possible exception of mangoes.

Senator McLUCAS—Yes.

Ms Newton—Sugar cane obviously is not included in the horticulture ambit.

Senator McLUCAS—I understand that.

Ms Newton—Bananas are exclusively on the domestic market in any case and, while they are seasonal, they have a season of about six months which rotates. I am not sure that I can answer that question as you have phrased that, Senator.

Senator McLUCAS—All right. Thanks.

Senator FARRELL—Are you able to give us an indication of what percentage of the Great Southern and Timbercorp assets might be saleable?

Ms Newton—I am sorry, I have no idea.

Mr Swaddling—It is a very difficult question because it depends on what the receivers do in the short term as to the viability of any of those assets.

Ms Newton—I think it would be fair to say that some of the MISs have been absorbing existing farming properties into a different business structure so that an existing traditional farming family, for example, may have traded some capital injection for their skills in the management of and their technical skills for that particular commodity. That is a mutually beneficial arrangement that everybody is happy with. What then happens when the overall structure disappears, as Stuart says, is more up to the receivers than we were able to guess at.

Senator FARRELL—The reason that I asked the question is that I was down at McLaren Vale last week. There was a bit of concern there that those growers who were not part of managed investment schemes might find themselves in the situation where people are offloading managed investment scheme assets at a discounted price and therefore affecting their own viability.

Ms Newton—I would say that is a possibility, but as far as I am aware there is no research on that. I cannot really comment.

Senator WILLIAMS—The return on your horticultural MIS would be far quicker than forestry for example.

Mr Swaddling—In most cases.

Ms Newton—The vast majority. Olives might possibly be a small exception but most of the others would return quicker than that.

Senator WILLIAMS—Do you know what percentage of Great Southern and Timbercorp had their investments in horticulture?

Ms Newton—I have no idea. I am sorry.

Senator BOYCE—You did mention earlier, Ms Newton, I think, that there had been benefits from the existence of horticultural MISs for local communities. Could you give us some examples or talk a little bit more about that?

Ms Newton—If I can broaden that to say corporate investment or agribusiness, not just MISs, certainly. Some of the noted benefits are in research and development. Many of them have the capacity and the wherewithal to investigate new varieties, for example, or different techniques for water use efficiency or a whole range of technological improvements that, if they are an integral part of the industry and willing to share that information, can improve production capacity for all of the participants if they wish to take up the technology. That has been a potential. Obviously some of our regional communities have benefited from the injection of capital and cash within the community. That is everything from the irrigation contractors and the fencing contractors right through to the processing—

Senator McLUCAS—And the local accountant, one hopes!

Ms Newton—You are probably not aware that horticulture works in our regional communities on an average direct multiplier factor of around five so that is packing houses, processors, consultants and agricultural services suppliers. Then of course there is the next ring out of who shops at the Woolworths and local supermarkets and those sorts of things, right through to the rates at local councils. There are demonstrated benefits that corporate investment in horticulture has been able to deliver into local communities.

Senator BOYCE—Obviously, this enquiry is focused on MISs. Are you able to make any distinction between corporate investment and the MIS type of investment?

Ms Newton—Again, it is very difficult to generalise. Those MIS organisations which are well run and have the appropriate governance, reporting, transparency et cetera processes in place are almost indistinguishable from any other kind of agribusiness activity. Our concern is that not all of those have been in place before operators and there have been some issues—you have heard them from others, I am sure—around the commissions paid to accountants or financial advisers right through to a whole range of other corporate governance issues that ASIC raised, I think, back in 2003. We would share some of those concerns. Certainly, we have concerns about the level of involvement that all of the MISs have in engaging both with their broader industry and with their local community. Some do it very well; some do it, I think it would be fair to say, poorly. As I said earlier in my introductory remarks, we are looking for guidelines, regulations and frameworks that will encourage that to occur properly and discourage it from occurring improperly.

Senator BOYCE—Are you perhaps able to give us some examples, obviously without being specific unless you wish to be, of poor local engagement—problems that have arisen that you are aware of?

Ms Newton—I think it would be fair to say that where local communities and local growers complain bitterly about the behaviour or the impact of a particular company on things like prices and availability of land, water and labour, for example, or their impact on the domestic prices I outlined earlier, then you would have to say that there have been some poor practices in their communication with their local community and the industry that they are supposed to be a part of and/or there are other poor practices involved. I do not want to name names.

Senator BOYCE—No, I am not suggesting that you might want to name names. How is that different from market competition operation?

Ms Newton—As Senator McLucas referred to earlier, it is a distortion in the market—

Senator BOYCE—Because of the tax deductibility?

Ms Newton—Yes.

Senator BOYCE—So you might have a family farm and an MIS trying to do the same business side by side and one has a distinct tax advantage over the other.

Ms Newton—Yes.

Senator BOYCE—Is that the core problem as far as you are concerned?

Ms Newton—Yes, because it focuses on the capital input costs and the tax benefits to be gained from that rather than on actually producing a long-term sustainable and viable business, which should be the focus.

Senator BOYCE—Getting back to companies that have poor relations, are there other factors affecting those poor relations?

Ms Newton—They are probably the most common complaints I hear. On the other hand, we have mentioned in our submission an example on the other side of things where the almond industry—again, naming no names—has collectively got together with both the traditional farming business structures and the more modern corporate agribusiness or MIS business structures and forged a way forward for the industry as a whole. We see that as a very positive model that could well be adopted for other industries. Unfortunately, that has been patchy in other industries, it would be fair to say.

Mr ROBERT—How has the granting of the ability to claim a tax deduction upfront for MISs affected your industry?

Ms Newton—Which one?

Mr ROBERT—You represent 97 per cent of the horticultural industry, everything from mushrooms to all sorts of—

Ms Newton—Indeed, and that is the issue—they will vary between the different commodities.

Mr ROBERT—My reading of what you are saying—I could be wrong; correct me if I am—is that you would like to see the tax deduction removed from MISs. You believe it grossly distorts agribusiness. I now assume that it has therefore had an impact on your members, whether it is taking water, taking land, dislocating rural communities or all of the above and some.

Ms Newton—They are the complaints that we have received, plus the potential for oversupply on the domestic market and the consequences for local prices. As I say, there is some evidence to suggest that those accusations are accurate in some regions and for some commodities. There is less evidence in other cases to demonstrate that has actually been happening. But they are the consistent causes of complaint that we have received.

Mr ROBERT—Is your overall contention that the government providing a tax incentive is not only economically but socially dislocating markets and communities?

Ms Newton—Potentially, in the way that it has been operated by some of the MIS operators.

Mr ROBERT—The next obvious question is: can you back that up with some hard, quantifiable, measurable data?

Ms Newton—No, and I am not prepared to name companies at this point either.

Mr ROBERT—Your written statement is quite clear: you would like to see it removed. But there is actually nothing from a tangible point backing that up. If the committee is going to make a recommendation it actually needs something to back it up.

Ms Newton—I understand. The only research that I am aware of that has been done in this arena is the one that I referred to earlier in response to a question from Senator McLucas.

Mr ROBERT—Is your association doing any greater research or quantifiable measurement?

Ms Newton—At this point, no.

Mr ROBERT—Thank you.

CHAIR—Is it your view, given your submission and some of your recommendations, that there is too much investment now pouring into MIS schemes and that the market, in a sense, is fixing that?

Ms Newton—I do not know that I would go so far as to contend that. I certainly have no evidence to suggest that is what is happening. My point of view is that it is probably more a matter of management issues and governance issues than anything else, but that is a personal point of view.

CHAIR—So there is capacity and it is not a case of there now being overinvestment and less demand. You are saying it is more focused on management and other issues.

Ms Newton—I believe so.

CHAIR—You say there should be no tax break for MIS horticulture. Is it your view that the eligibility to qualify as an MIS is too wide?

Mr Swaddling—The focus is on the upfront tax deductibility rather than the end of production. That is what needs to change. While the dollar is driving the investment upfront, you do not necessarily get the right result at the end of the time, which can mean overproduction or nowhere to sell the product. We would like to see the scheme take into account the final product as the main driver for investment rather than the tax deductibility upfront for capital works.

CHAIR—Would you get investment in a 15-year project with no return if you did not have something upfront? Isn't that the whole point?

Ms Newton—Other people in the horticulture industry are doing it, so I would have to say yes, clearly.

Senator McLUCAS—It is a question of the motivation of the investor, isn't it?

Ms Newton—Exactly.

CHAIR—So it is reasonable to say that there would be investors. I am talking not about farmers who live on the farm and invest but investors, where you just need to have capital inflows or—

Ms Newton—Corporate investment in horticulture, as we would call it, or agribusiness—

CHAIR—corporate investors that are prepared to wait 15 years.

Ms Newton—Absolutely, because it is a good investment.

Mr Swaddling—With most horticultural crops there is cash flow from three or four years out in many cases, not sufficient to cover all the costs—

CHAIR—But certainly not in forestry or trees, though.

Mr Swaddling—No.

Ms Newton—But that is not our field.

CHAIR—So you are quantifying your statements strictly in terms of horticulture.

Ms Newton—Absolutely. It is not the MIS model in general that we are opposed to. I remember back to the 1970s, when the Australian government introduced a similar scheme to encourage corporate investment in the arts. I think the Australian film industry and perhaps opera and other art forms were grateful for that investment that may not have otherwise occurred. It is not the in-principle but the 'why would you bother to do it in horticulture', when as far as we can tell there is significant other corporate investment in horticulture prepared to put that capital in and wait for the return.

CHAIR—Would you go so far as to say that even within horticulture there might be a difference between different crops in terms of lead times and investment potential?

Ms Newton—Absolutely. With most of the stone, pome, cherry and similar kinds of fruit and vine fruits you could get a beginning return on investment within one to two years with modern technology and intensive plantings. You will get full productivity within three to four years, so your return on investment is really quite rapid. On the other hand, with macadamias, olives and almond trees, you are looking at longer lead times of seven years through to perhaps 15 years. So it definitely depends on the product.

CHAIR—Do you think this committee should be looking more closely at the individual crop in terms of either eligibility or how it is treated in tax terms? Should they all be treated the same or do you think we should be looking at making a distinction between MIS forestry and non-forestry, and within non-forestry looking at those that within two or three years might have a return?

Ms Newton—We would certainly appreciate a distinction between forestry and non-forestry, but I do not believe it is necessary to make that kind of distinction between horticultural crops if

the basic governance and investment framework is correct—the motivation, as Senator McLucas has said.

CHAIR—There being no further questions, thank you very much for your submission and your evidence today.

[3.52 pm]

D'ALOISIO, Mr Tony, Chairman, Australian Securities and Investments Commission

HANRAHAN, Dr Pamela, Senior Executive Leader, Investment Managers, Australian Securities and Investments Commission

MEDCRAFT, Mr Greg, Commissioner, Australian Securities and Investments Commission

CHAIR—I welcome the witnesses from the Australian Securities and Investments Commission to this public hearing. I invite you to make some opening remarks.

Mr D'Aloisio—Thank you, Chair. As you know, we have put in a submission and we have asked for a ruling that appendices 2, 3, 4 and 5 be kept confidential. We understand that you have agreed to that and we would like those treated so. By way of brief explanation, clearly some of the matters that we go into those appendices are related to our ongoing investigations and inquiries into recent collapses and hence we have claimed that confidentiality. What we have really provided to you in terms of our materials, as we are doing with your other inquiry into financial services, is information that hopefully will assist the committee in its deliberations. There is a significant tax aspect to this inquiry. As you would know, that is not an area of our responsibility. That goes to government policy and the Australian Taxation Office and hence we are not commenting or providing information in relation to the tax issues.

By way of making further comments, I think that when we sit back and look at this in terms of where our inquiries are going in looking at managed investment schemes, particularly the ones that are in difficulty, we see that for us—and I guess this is a matter for the committee—there are probably three issues that are emerging for further discussion and debate. The first of these is clearly the business models and the way that liquidity and capital have worked with these schemes. Here it is worth pointing out that there is a significant part of our market that is not APRA regulated. As you will recall, we have talked before about the underpinning to the Corporations Act at the moment being the Wallis inquiry, which made a distinction as to allowing the market to operate with ASIC as an oversight body, overseeing in particular market linked investments, managed investment schemes and so on, compared to prudentially regulated entities which are primarily the banks and insurance companies that are regulated by APRA. 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.

The second issue that emerges is an issue has been in the public arena. It is the role of financial advisers in advising as to these products and the way they are distributed in terms of commissions and so on. Again, these are issues that the committee is aware of. There is, I think, a third issue that emerges from that policy setting. It is in terms of the work we do on investor education and on ways of getting the risks of these sorts of products conveyed to investors. It is about whether indeed 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. As I have said, they are three of what I would call the bigger picture issues that no doubt are emerging for the committee, and if we can assist you as to those and other issues we would be pleased although these are essentially policy matters for you and government and not matters on which ASIC will necessarily express a view. Other than that, Chair, I think it is probably better that we go to questions and answers and we will see if we can assist you in that way.

CHAIR—That would be great. Thank you, Mr D'Aloisio. We will start with the issue of monitoring. The ACCC certainly does some monitoring, APRA has limited monitoring in terms of the parts that it regulates and ASIC has monitoring in terms of the licensing regime, related entities, independent custodians, the compliance plan and the compliance committees. I am wanting you to explain to us your role in practice and your role in theory in the monitoring of the schemes.

Mr D'Aloisio—In section A of our submission we actually outline for you the surveillance work that we have done over the past three years, the sort of deterrence action we take, the action we take on illegal schemes and the disclosure campaigns that we run. ASIC runs or conducts them or is involved in a number of ways in overseeing the markets it regulates. For example, we monitor disclosure surveillance—as you see in paragraphs 114 and 115—with the sort of work that we do—115(b)—where we look at the PDS and whether they are defective or not and get them corrected. We look at misleading statements and so on. We have detailed there the range of actions that we do. But 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.

The furthest we have gone in looking at business models and pushing disclosure has been in the unlisted, unrated debenture area. We felt that the disclosure in that area needed to extend to benchmarks on capital and liquidity requirements for those particular types of investments for retail investors, so we adopted a regime on an if-not-why-not basis so if there was not sufficient capital according to our benchmark that was an issue and we needed to say that to investors so investors knew, on an if-not-why-not basis, whether they would still invest, knowing that the capital adequacy that ASIC had set might not have been there. So that is the furthest we have gone, but that is essentially pushing the disclosure regime as far as we can. Our powers and our oversight—while we do all the things that are outlined in our submission—do not extend to be able to say to an entity, 'Look, we think your model is going to fail commercially and you should not offer it,' because, under the policy settings that exist, that is a matter for the market.

CHAIR—Have you got any concerns in relation to the responsible entities self-administering or the way they set up the structure in terms of holding the assets and the independence of individual directors or the people that are part of these entities?

Dr Hanrahan—The existing law requires that there be this single responsible entity. The way in which it operates depends on two underlying principles. The first is that there are very onerous legal obligations imposed both on the responsible entity itself and on the individual directors and other officers to ensure that they always act in the interests of the investors and that

they prefer their interests over those of the corporate entity. So there is that aspect to it. The second aspect to the supervisory or regulatory framework—

CHAIR—Sorry, their responsibility is to the investors?

Dr Hanrahan—Yes.

CHAIR—My understanding was that it actually was not.

Dr Hanrahan—No. Their responsibility is to the investors in the managed investment scheme. Both the company and the officers of that company owe a direct legal obligation to act in the interests of the members of the scheme, the growers—

CHAIR—Of the scheme itself? Definitely the members?

Dr Hanrahan—The members of the scheme, that is right. If the interests of the members conflict with the interests of the corporate entity, there is a statutory obligation to prefer the members' interests over those of the corporate entity. That is a real linchpin in this single responsible entity model. There are very strong legal obligations there. The second linchpin, if you like, in this model is a very high emphasis on self-regulation. The responsible entity is required to put together a compliance plan that ensures that it operates the scheme in accordance with its various legal obligations. Then there are mechanisms built in there for monitoring compliance with that plan.

CHAIR—But is there enough separation between all of those parts? Isn't it the same people reporting on themselves creating and setting these things up themselves? Isn't it in the end all the same people doing all the same things under different guises but there is no real separation between any of these acts that they have to perform or requirements that they have?

Dr Hanrahan—It is true, yes, that there is no independent person—for example, an independent trustee, as we had under the old law. There is nothing like that. When the law was changed back in 1998, it was felt that that would be adequately addressed by having these express legal obligations imposed on people to deal with the conflicts of interest that that structure might create.

CHAIR—Is there a fiduciary responsibility as part of this or is it just a responsibility of some description but not a fiduciary responsibility?

Dr Hanrahan—I am smiling because that is a complex question of law, but it is fiduciary in character, we could say.

CHAIR—Is it also the case, though, that there is no requirement for these entities to report any breaches of the Corporations Act?

Dr Hanrahan—No, that is not correct. There is an obligation for them to report breaches of their licence if they occur, breaches of the relevant provisions of the Corporations Act. If they have a compliance committee, which many of these entities do have, and that committee is concerned that the schemes are not being appropriately operated, then they are required to report

that concern to ASIC. There is a further check in there. There is an independent compliance audit done by a registered company auditor. If they find concerns about the compliance within the scheme, then they are obliged to report those concerns to ASIC as well.

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. There were some directors who made public comments about—

Mr D'Aloisio—Former directors.

CHAIR—Former directors, of course, because they resigned.

Dr Hanrahan—In one of the companies, two of the directors did resign a couple of years ago, yes. I believe they have made public comments about what prompted that resignation.

CHAIR—My question is: do you have concerns about the background to that? Why did they feel so strongly that they needed to resign, that they could not resolve what we could call those 'internal conflicts'? Perhaps the structure of the system that exists now is very inward looking rather than having the true independence of someone who is external completely. That sort of independence just does not exist—maybe in theory but not in practice.

Mr D'Aloisio—I need to assess that a little bit, Chair. It is not unusual in the corporate world for directors to resign from companies where they feel that a strategy or the direction of the board or of a group of directors is going in a particular way. Generally speaking they would resign, and whether they choose to make a public statement or not or speak to ASIC will depend on the circumstances. So it is not an unusual event. In the context of REs, whether our interests would be excited or not would depend on the reasons that they were giving. If they were commercial differences and differences on particular issues, that is not likely to excite our interest. If they were to do with impropriety, then of course we would in the normal course investigate that.

Senator BOYCE—Thank you for your submissions. They are both really helpful in working out what we should be doing next.

Mr D'Aloisio—Thank you.

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. The question you are getting to is if you have someone who is continually—

Senator BOYCE—Recalcitrant.

Mr D'Aloisio—recalcitrant, what do you do about it? Do you just keep saying, 'Tony, fix it' and at some point in time you might take other action? We will answer that more specifically. But generally speaking these do tend to be one or two incidences where people fix them and they move on, then something else that is misleading might be drawn to our attention or we might find it and that gets fixed. Of itself, if we felt it were so serious we would then look at the issues of the licence and look at taking other action.

Senator BOYCE—Or there might be something in the corporate culture that might need remedying. Would that be something that you would consider?

Mr D'Aloisio—Yes, we would look at that.

Senator BOYCE—After one or two incidents you would start to say, 'Sorry, we're not going to tackle it this way.'

Mr D'Aloisio—Yes, that would be the position.

Senator BOYCE—We had some evidence earlier today around the role of the independent forester in some of the forestry MISs. I am not entirely clear on what the required role of the independent forester is. What was suggested to us was that the role of the independent forester should be quite clearly specified and that perhaps the independence of that person should be strengthened by regulation or legislation. What is the view of ASIC on the current role of the independent foresters, where they exist, and what it perhaps should be?

Mr D'Aloisio—Experts do offer opinions and opinions are put in PDSs and so on in all different scenarios. We could probably talk a little about our experience with the independent forester, but I do not think we have any specific view or reform.

Mr Medcraft—Dr Hanrahan may be able to speak about guidance we receive from independent experts and how they act.

Dr Hanrahan—We do. Where they interact directly with the regulatory setting is very much around disclosure—the provision of experts reports and the provision of information to investors over the life of the scheme as to the state of the assets and so on—rather than having some statutory role as a kind of expert in—

Senator BOYCE—It is almost an auditing type of role that is being suggested. On one hand it has a certain appeal; on the other hand it has the potential to perhaps function the way ASIC approvals and ATO approvals currently do in giving people false confidence or being misused to market a product as being better than it is. I just want to explore those views.

Mr Medcraft—A perhaps relevant comment on that—and Dr Hanrahan may like to add to this—is that an independent expert does have a legal duty of care and a whole set of law surrounds the duty of care that an expert owes to the person relying on their advice.

Senator BOYCE—Nevertheless, we did have evidence today from someone who has performed that role pointing out that he runs a small business and would like some more business. There is a tension there. I am certainly not suggesting that he behaved in any improper way, but he was suggesting that there is obviously a tension there.

Mr D'Aloisio—You have to look at the tension also in the context of the investor. The difficulty is that, if you are looking at this person as offering a view on the viability of these things over a long period of time and people then rely on it to invest, that is a big call to ask anyone to make. Basically, a risk-free investment in horticulture or these things that extend over such a long period of time is not possible. Indeed, the more you build into it that ASIC has looked at it, the ATO has looked at it and an independent expert has looked at it, the more you create an air that this thing is too good to be true or the sense that this is a good product and the risks have been well thought through. The risks associated with these must remain with the board of management, the chief executives and so on who put them together and have the ability to look at them as a viable commercial enterprise. That responsibility should remain with the directors and the executives. Experts can come along and offer an opinion about how trees may grow and drought and about compliance systems, but, in the end, if you are going to put a commercial enterprise together and you want people to invest in it, the responsibility has to remain with the boards and the CEOs.

Senator BOYCE—What would your view be of an independent expert who reports to the marketing manager who is not a director of the entity?

Mr D'Aloisio—I think these things could assist. I think quite clearly you are grappling with the question of how to get a degree of additional independence to assist investors in their decision making. Do not get my comments wrong—the things that you can do to assist that are all worthwhile and, if you can have an independent view and greater independence on certain aspects, I think we would favour that. But we are giving a caution that there is at the heart of this a very, very risky venture. It is about projecting 10, 15 or 20 years in terms of taking your front-end benefits and then waiting for a period of time to get your return.

Senator BOYCE—And relying on nature as well.

Mr D'Aloisio—Part of our job is to get that risk out. Some of the material we have given you and the stuff that is on our website and so on is really aimed at saying, 'What are the questions you should ask yourself before you invest in this? This is a 10- to 15-year investment. Are you aware of the risks?' There is no doubt that we look at the risks in the PDS and they are listed, but it is a question of understanding that risk and really translating it into balancing the immediate, initial advantage that one gets by investing in it in terms of tax deductions and so on against being prepared to wait and take the risks out in 15 or 20 years time.

That is the really difficult judgment here for investors. That is why I made the comment earlier that maybe this is an area where we need to think carefully about how far we can assist and educate retail investors. In the end the best advice that financial advisers can give investors is perhaps to be careful and, if they are going to invest in these, to keep it to an absolute minimum and treat it as a really speculative part of their portfolio. They should have their asset allocation in a way that they still have their other investments but, if they are going to go into something like this, understand that it is more speculative, it has greater risk. Investors should give themselves a period of time and be prepared to lose the amount that they have put in. When you look at the amounts that have gone into these and some of the other materials we are looking at the investments are ranging from $10,000 or $15,000 to $100,000. So there may well be a lot of investors out there—we have not completed our work—that may be taking the exact view that I have just talked about. 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.

Senator BOYCE—I asked the Financial Planning Association earlier today a question on research about investors, types of investors, classes of investors. I know you are doing some work in that area. I got the impression that the only other people who would be doing work in this area were corporations who were interested in understanding their own customers. Is that your view of who is working in this field?

Mr D'Aloisio—I think you are right, companies that are interested in advising on products and distributing product would no doubt do their research about target groups. We are doing research in understanding buying decisions, how they are made and why. Other than that I am not aware of other groups that would be doing this sort of research.

Senator BOYCE—No other government or statutory bodies of any sort.

Mr D'Aloisio—Not that I am aware of. The ACCC may be doing it as well but in relation to its areas.

Senator BOYCE—I have one question regarding the confidential submission but it is a very general question, so I shall start to ask it and if you are concerned at all, leap up. You have told us here that you are analysing some information about yields that was provided to you by some research people. I was not intending to name the research groups unless that is acceptable to you. What I was wanting to know is who is their normal audience? Is it a general audience or a group that would pay? Who would those research houses conduct that research for?

Mr D'Aloisio—Would you be able to direct me to the part of the submission?

Senator BOYCE—It is page 53, appendix 2, 178. You have said there that you have reviewed a sample of yield information based on analysis conducted by research houses and named them. Who normally sees this research and who pays for it et cetera?

Mr D'Aloisio—Research houses typically put out their research reports to the market, to investors and to the managed investment funds themselves. It could be available and it could be bought.

Mr Medcraft—Both ways.

Senator BOYCE—But the documents you have had are not publicly available documents. They would generally be used by people who are trying to sell these products.

Mr D'Aloisio—Yes. That is there to give you a feel for our view on what is going on at the moment.

Senator BOYCE—It is very useful. Perhaps every investor should have it!

Ms GRIERSON—I understand there are some complexities for you in answering questions because you are involved in trying to shape the future directions in terms of regulation and the role of ASIC. Given that constraint, we would still want to have some answers from you on what we might look forward to in terms of some of the evident problems with these investments.

Mr D'Aloisio—In the submission that we will be giving you at the end of July for the related inquiry we are trying to go further. I think I have indicated today that there are certainly three areas that are starting to emerge in our minds as quite significant. We are seeking to go further and give the committee options in terms of potential areas that you might want to see changes in. But at the end of the day our role is really to point these things up. If we form a view that a change is needed, our first port of call would be to then write to Treasury and to the minister under the act and outline why we think the change needs to be made. If as our work is continuing we form that view, we will do that and advise the committee that we have done that.

Ms GRIERSON—So would you be confident at this stage to say that there is a greater need for regulations, standards regarding financial advisers and the role they play?

Mr D'Aloisio—I think the issues that are emerging, as we said, in the end it is a matter for the committee but certainly the commission structures and the way that advisers are advising and have advised investors in these and other collapses that we have looked at, they do raise issues that need to be answered. I think this committee will get those answers. But certainly the role of advisers needs to continue to be questioned.

Ms GRIERSON—The nature of investment products is another area that is touched on by this inquiry and the other one. What is ASIC's potential role or present role?

Mr D'Aloisio—It is a difficult issue because what we are seeking to point up to the committee in relation to that is that we deal with a policy setting that currently exists. That policy setting. based on the Wallis inquiry, is primarily let the market sort things out, regulate bad conduct and push disclosure. ASIC's role in that context is to oversight to ensure there is disclosure and to

punish wrongdoing such as misleading and deceptive conduct. The question for the committee and for us is whether the setting and the way that it is set, with the benefit of what has occurred, should be pushing more when you look at retail investors. When the institutional investors do not take up products, they tend to come down to the retail investor area. Is there additional protection that they need in addition to good advice and a financial advice system that does give them good advice? Are there products that are so complex that from a regulatory point of view there should be some sort of obligation on either the issuers or government that those products either are not available to retail investors or if they are they need to be done in a particular way. So it is an issue for you whether the settings that exist need to be pushed in another direction. The counterbalance to that argument, to be fair, looking at the two views, is that when you look at the markets and you look at the efficiency of our markets they have led and provided very low cost capital, they have provided capital across a range of areas of what we would call linked market investments, whether they be property, whether they be trees et cetera, that may not otherwise have been developed or at least not have had access to that. So the efficiency of the capital markets needs to be balanced against that need for greater protection.

Ms GRIERSON—I would say to you that what we are talking about in this inquiry and the other one is greater protection to the most vulnerable of investors.

Mr D'Aloisio—You are.

Ms GRIERSON—It is a growing class of investors and they are vulnerable, and it is the ordinary mums and dads of Australia who have lost a great deal. The market has been fine and over time the market will be fine again, but there are always going to be vulnerable people. Are you also looking at the conduct and behaviour and protocols around administrators and receiverships?

Mr D'Aloisio—We have a number of programs in our insolvency and liquidation and our other broad responsibilities that we have, and certainly we very much monitor and are involved with the insolvency industry—liquidators, managers and administrators—on how they operate, how they charge and so on. So, yes, we are heavily involved in that whole area, in audit and the review of auditors and so on. So, yes, we are.

Ms GRIERSON—In your submission you point out that ASIC had provided cautionary education materials regarding agribusiness. You had outlined risks to people. I assume there is not at the moment, but should there be an obligation on advisers to make sure that people have had these drawn to their attention and they sign that they have seen them? I know it will not necessarily change human behaviour, but it seems to me that a lot of people would not go onto your website and find that information. They just would not realise it is there.

Mr D'Aloisio—Advisers have got a statutory obligation. They have got to develop products and consider the circumstances of the particular investor and give them proper advice on whether that product is suitable for them and so on. So the law is already doing that.

Ms GRIERSON—It seems to me that the actual investor has to have that material made available to them.

Mr D'Aloisio—They do in the form of what is known as a statement of advice. It is provided to them. I think these are areas that we can explore further with you and see how we can improve our own pushing of these issues. The issue I think you are getting to is that an adviser can give you all that information and give you the statement of advice and it can have the risk but in the end it is the recommendation of that adviser that is most likely to influence you. That is only as good as the quality of the adviser in analysing the underlying product. That is where, I guess, in looking at our training and other programs and trying to get the quality up, if an adviser has not themselves understood the actual underlining product and the risks associated with it, they may not give the right advice to the investor. We do not know.

Ms GRIERSON—You know my view has been that in the past I did not feel you had the resources or legislative support to do the job that perhaps the public thought you were doing. I wish you well now with achieving those outcomes and I think the public particularly wants ASIC to deliver.

Senator WILLIAMS—You talked about investments in these being long term and the obvious risks of climate, seasons et cetera. Surely the tax deductions would be a way of compensation for them and encouragement to invest in these things because of that huge tax deduction they can achieve. It would outweigh the end result 20 years down the road, is what I am saying.

Mr D'Aloisio—It depends on the investor. There may be investors who might, for example, from the point of view of their planning and financial position in a particular year be looking at the investment and they say, 'Look, there is a possibility that this will give me a return and it may not. I am prepared to take the risk because I am going to get a bit of an advantage up-front. It is not the purpose I am going into it but, you know, I get this initial benefit and I am prepared to punt the risks associated with it long term.' I think we will find there will be a lot of investors in these things who did it that way. But there will be those who genuinely went into it on the basis of thinking that they were getting not only an initial benefit through the deduction but they genuinely believed that the performance of these entities would have yielded at the end of the day the sort of internal rates of return that the product disclosure statements have shown to those investors. At the moment we do not know what percentage overall, but certainly we have sufficient concern that the way investors were advised on the products they were advised on it as a long-term investment as well as having that benefit of the front-end deduction.

Senator WILLIAMS—I want to raise another issue from the Institute of Chartered Accountants this morning in their submission. They say:

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

This is a licence condition example: 'This licence authorises the licensee to carry on a financial service business to provide general financial product advice for the following classes of financial products: interests in managed investment schemes limited to own managed investment schemes only.' The institute believes this is an area that should be specifically addressed. Could you contribute anything at all to what the Institute of Chartered Accountants is saying?

Mr D'Aloisio—Theoretically, it is possible for you to be authorised as a representative to advise on a specific product and still give proper advice. The question in your mind and my mind immediately is: what if that licensee is a Timbercorp or a Great Southern and if the authorised representative is accountant A and it is only in relation to Timbercorp products? It does raise our concerns and your concerns as to whether that adviser or authorised representative is giving proper advice—still subject to all the obligations under the act in relation to statements of advice that I spoke about earlier. It raises the concern in your mind and ours—and obviously that is an area that we are looking into—as to whether that advice was given properly given that sort of circumstance. Whether that is an area for regulatory legislative reform, I am happy to give that more thought, and I am sure the committee will as well.

In the other inquiry, you might recall, Senator, we highlighted this issue of the authorised representative and we have made some comments on that. And we will be making further submissions in relation to the authorised representative regime, because one of the other limitations in that regime is that it is not as easy for ASIC to ban authorised representatives. It is much easier for us to be able to ban the main licensee and much harder with authorised representatives. That is another issue we will be taking up.

CHAIR—I might follow on from that because I want to gain a better understanding. Is it realistically possible for someone who is authorised under somebody else's licence to only provide advice on one particular product—to do anything bar recommend that product?

Mr D'Aloisio—Conceptually, it is possible to be able to give proper advice in relation to that product. For example, the authorised representative may say, 'I'm the authorised representative for X timber group and I've been advising my clients on these things over a number of years. Actually, I don't think this year you should go in, because I'm not happy with this particular new product and I'm concerned about the long term with water the way it is and so on and the prices they've shown for water, and I'm not satisfied. So even though last year I said to you to go in it'—

CHAIR—That is possible but highly unlikely.

Mr D'Aloisio—I am saying conceptually it is there—

CHAIR—Conceptually, yes.

Mr D'Aloisio—but I think when you then add other factors, you have got those factors and then you have got the front-end payment and you may have other relationships between the accountant or—

CHAIR—I think you have got out point and our concern.

Mr D'Aloisio—I do not think my conclusion would be different to yours. They are obviously issues that we want to look at.

CHAIR—It is obvious that you share the same concerns that we have. I have also got an issue in terms of the single product licensing arrangement where thousands and, in some cases, even tens of thousands of people, be they accountants or otherwise, are sub-licensed to provide so-

called advice and really may not have any qualification to be able to provide that advice—the real qualification to determine whether this produce is a viable investment—beyond the authority of the license holder.

I might just give you one example to highlight what I am speaking about, because it goes to the issue of disclosure and whether there is enough disclosure in terms of the investment. I would say that in most cases there is plenty of disclosure. In fact, if people turn to the produce disclosure statements, they will see that all the information is contained. We heard evidence from Plantall Forestry Consultants. They did a particular case study and reviewed a 2008 PDS which received ATO product ruling. In that it required an investment of $11,400 per hectare with an expectation that returns in eight to 12 years time would be at least $9,000 in 2008 values, netting a loss. It was clearly stated in black and white that this investment over an average of 10 years would lose money but the people authorised to recommend it obviously did so in hundreds if not thousands. I am not going to make any judgment as to why they would recommend an investment that said upfront that they would lose money, but obviously it was not on the basis of the merit of the investment itself. Does this not appear to be on the surface an issue of disclosure? We have heard it through other submissions that there is plenty of disclosure. But the advice is still to go ahead and invest regardless of whether there is a return. I am concerned about that in particular.

Mr D'Aloisio—We would be concerned about that as well. I guess this goes back to what I was saying earlier. The real issue with these because of the incidental or the impact of getting the tax deduction upfront and the instant return is how much that affects the overall judgment about the longer-term risks. There may be investors who, when they look at their cash flow position and everything else, might still say, 'Even though its going to make a loss, we're still overall going to break even or make a slight profit or a slight loss,' and the actual immediate cash impact of taking the deduction might be such that they will still invest in it.

CHAIR—So it really does not matter, in a way. Does an investment have to have at least some potential?

Mr D'Aloisio—I am not suggesting that from the point of view of the adviser. The adviser must understand the longer term return product and must be able to point that out to the investor. All I am saying is that if an investor is excited by the front-end cash advantage they may be prepared to take a punt on that loss on the basis of: 'Well, you could be wrong, you know. The trees might grow. Things might change. We might get more for that timber than is projected.'

CHAIR—In relation to this particular one, the best-case scenario would be a loss.

Mr D'Aloisio—The problem here is that you want the adviser to be able to make the investor understand all the risks associated with this, and this product in particular. These products are difficult. The risks associated—

CHAIR—I understand. I am just particularly concerned about the quality of advice and whether, then, the licensing regime and the qualifications that are required are really satisfactory. I mark that as a concern. Certainly these are promoted, marketed, sold on—perhaps it is not really advice at all; perhaps it is purely sales.

Mr D'Aloisio—We are seeing in the other inquiry and in this inquiry, as I said earlier, a concern about the role of financial advisers. We go back to this issue where we want financial advisers and we want to lift training because we know that ultimately investors will be better served by having advice. But if it is not working and if we continually see examples of areas where there is conflict of interest or potential conflict of interest, and if the risks are not being pointed out, then from our point of view we can see strong arguments for going in the direction of separating sales from advice—which is the issue that the committee is considering and which is a matter for the committee.

CHAIR—Can I turn your direction to the responsible entity, particularly the accountability of the responsible entity and the qualifications of the people that sit on these entities. I have heard the response that they are responsible to do X, Y and Z. But is there any legal requirement? Are there requirements that stipulate just how that works? It appears to me that there are no requirements for any qualifications whatsoever for people to sit on these panels, entities or whatever you want to call them, that they really are internally appointed. Even more concerning to me, there are no mechanisms for their removal if they fail in any particular manner. There is no particular mechanism for an appointment, either.

Dr Hanrahan—The responsible entity is required to hold an AFS licence. In order to qualify for that licence it has to demonstrate that it has certain competencies and so on. One of the things that is looked at in connection with the licensing is the experience—and the qualifications—of the individuals who will actually be running the business. The licensing regime is set up in such a way that an applicant needs to demonstrate that there is somebody who has appropriate experience and qualifications in running a financial scheme, if I can put it that way. Also they are required to demonstrate that they have what is called a responsible manager who understands the underlying asset class—so somebody who understands how you pollinate almonds, for example, which is very much on our minds at the moment. Built into the licensing regime are some licensing qualifications in terms of the people who sit on the board or in the senior executives of the responsible entity.

The responsible entity then, under the Corporations Act, is subject to quite onerous direct legal obligations to act with care, to act in the interests of the growers, to constitute the schemes in particular ways, to put in place compliance arrangements and so on. As I have said, there are additional external checking mechanisms around the rigour of those compliance arrangements using, in particular, either a majority independent board of directors, or what is called a compliance committee. Then those arrangements are subject to an additional layer of audit by a registered company auditor of compliance. So there is a web of accountability structures built in.

CHAIR—If that is the case, though, and I accept what you are saying, isn't there some sort of perverse irony in the fact that, in the case of Timbercorp—and you have got to understand that Timbercorp and Great Southern represented 50 per cent of the totality of the market—

Dr Hanrahan—Yes.

CHAIR—the responsible entity was actually KordaMentha, and KordaMentha are now also the receiver. It would seem to me that there is some sort of perverse conflict of interest where the people charged with the responsibility of ensuring the success of the scheme are the people who end up actually putting it into receivership—or administering it through receivership. Isn't there

some sort of conflict of interest there—the person charged with, let us say, making sure that something succeeds is the person who benefits when it fails?

Dr Hanrahan—We are aware that there is a very high level of anxiety amongst the investors in those two entities in particular about the role of the administrators, or the insolvency practitioners, that have come in there. There is a legal answer to that question—

CHAIR—I would be happy to hear the legal answer and then perhaps a view in terms of the conflict.

Dr Hanrahan—and then there is an issue about how the growers feel about it. When the insolvency practitioners come in, in the case of Timbercorp, KordaMentha were appointed initially by the board of Timbercorp and the subsidiary companies as administrators under voluntary administration under the act. Their duties were to act in the interests of the company and, as individuals—two individual insolvency practitioners were actually under a personal statutory obligation—to act in the interests of growers and to prefer the growers interests over those of the Timbercorp entity in the event of a conflict. As a result of that there have been various proceedings in Victoria in the Victorian Supreme Court and in the Federal Court testing that proposition and reviewing the actions of the administrators against that test. Subsequently, maybe two weeks ago, the Timbercorp entities were placed into liquidation and KordaMentha became the liquidator of those entities. The schemes themselves are not being wound up as yet. That is the subject of proceedings in the Victorian court today. So the schemes are still being operated by the Timbercorp entity as RE. The Timbercorp entity is obliged to act in the interests of the growers but, instead of its directors running the show, the two insolvency practitioners are. Their legal position is that they are under a statutory obligation to act in the interests of the growers.

That is the legal position. That is not to say that we do not understand very clearly that investors are concerned that there might be a divergence of interests there that they might have trouble managing and that divergence of interests might be between the interests of the growers, who obviously want to keep their investments on foot, and perhaps the interests of creditors of other members of the group.

CHAIR—Where is the ultimate legal requirement of now the administrator, the receiver, rest? It is obviously with the creditors first—

Dr Hanrahan—No.

CHAIR—No?

Dr Hanrahan—In Timbercorp a receiver has not been appointed; KordaMentha are liquidators of Timbercorp. I apologise for being technical, they are officers of the company and so long as the company remains as RE, they are obliged to act in the interests of the growers, because it says so in the Corporations Act. That is a difficult obligation for them to discharge—

CHAIR—Because they have both responsibilities, so it is quite complex for them?

Dr Hanrahan—Correct. As insolvency practitioners they are ultimately, if I can put it this way, part of the court—they operate under the supervision and guidance of the court. The way in which they have addressed that as a practical matter is that they have gone to the court and said, 'As officers of the court, we understand that there is a perception that there is a conflict between what might be in the interests of the creditors of the Timbercorp group and the interests of the growers in the individual schemes. How would you have us behave?' They have dealt with it that way.

CHAIR—It almost seems as if now they are changing hats and saying, 'Look, we didn't know it took place. The company was hopelessly insolvent while we were there as the administrator.' They just change hats and same entity says, 'We did not know that took place.' It seems that they cannot live in both worlds of saying on the one hand they were hopelessly insolvent at some point X, but, at that time when they were hopelessly insolvent, they were actually the responsible entity and dealing with the affairs of the company. How can they be doing both? Doesn't it pose a problem for them? Isn't the idea that whoever mismanaged and created or was part of the original problem should be separate to the person coming in trying to, let us say, clean it up and ensure the possible continuance of the organisation to meet its liabilities. How can it be the same entity?

Mr D'Aloisio—It is not quite the same. The RE is an entity. Its directors got to the point of saying, 'We may not be able to pay our debts as they fall due. We had better call in an administrator.' So they call in KordaMentha. They then take over as administrators and look at preserving what they need to do to see if the company can operate or not operate, whether it needs to go into liquidation and so on. So they are carrying out that duty. In the course of carrying out that duty they have gone to the court and said, 'There are competing interests here.' As Pamela said, there are competing interests with creditors and growers. We know we have to act in the best interests of the growers. Ultimately that is the default. But we need some guidance here on how we balance these up and whether we should put this entity into liquidation. That is where we are at at the moment. I do not think it is right to say that it was the same group of people that got into all—

CHAIR—I am just wondering about how they have the power and authority to appoint themselves.

Mr D'Aloisio—Under the law, if a company gets to the point where there is a risk of insolvent trading, there is no option: it must call in an administrator, otherwise the directors are in breach of their duties.

CHAIR—I understand that, but I mean the apparent authority to appoint themselves as the administrator in this case. So KordaMentha is the responsible entity then deciding it will appoint itself. Or is that not the case? It seems to me to be the same company.

Dr Hanrahan—The schemes themselves are currently not winding up. We are further advanced with the horticultural schemes run by Timbercorp. The forestry schemes are not quite at this stage yet. But you are quite right. KordaMentha has made an application to the court and said to the court, 'Should we wind up the schemes?' The judge has to make a decision as to whether it is just and equitable that that occur, so it involves the court making the decision rather

than KordaMentha. But they have made that application and that is being argued before the Victorian court today and tomorrow.

CHAIR—But they are still making the application to appoint themselves.

Dr Hanrahan—Correct; they are. As a result of that application having been made, the growers are separately represented in that proceeding. Indeed, ASIC is appearing amicus to assist the court in resolving this difficult matter. As a result of that, various evidence has been led about what the better option for growers might be. It is going to eventually have to be a commercial outcome. So the parties are working through that. If the court were minded to make a winding-up order then it can control how that winding up occurs and it can control who carries out that winding up as well. So we would not assume that it would be one party or the other at this stage, I do not think.

Mr Medcraft—Another party could be appointed as the liquidator. You would have KordaMentha as the administrator and a new party could be appointed as a liquidator.

CHAIR—But that would be a court decision?

Mr Medcraft—Yes. And the liquidator could also be directed as to how liquidation may proceed. The court could actually point out what they want to see is in fact perhaps a restructuring as opposed to a complete wind-up. I think you have to be very careful also because the regime under MIS is different than under Corporations Law.

CHAIR—We will see how that develops as we get an outcome from the courts.

Dr Hanrahan—It is live time, Chairman.

CHAIR—Yes. Thank you very much for your submission and for your appearance here today. I thank Hansard, all the witnesses who appeared today and the committee.

Committee adjourned at 4.48 pm