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Agribusiness managed investment schemes
Bitter harvest

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Abbreviations

AAG	Australian Agribusiness Group
ABN	Australian Business Number
ACCC	Australian Competition and Consumer Commission
AFA	Association of Financial Advisers
AFSA	Australian Financial Security Authority
AFSL	Australian financial services licence or AFS licence
AGAG	Agriculture Growers Action Group
Agribusiness MIS	Agribusiness managed investment schemes
ANAO	Australian National Audit Office
ANU	Australian National University
ANZ	Australia and New Zealand Banking Group
APL	Approved product list
ARITA	Australian Restructuring Insolvency and Turnaround Association
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001* (Cth)
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
CAMAC	Corporations and Markets Advisory Committee
CAP	Consumer Advisory Panel
CBA	Commonwealth Bank of Australia
CCLC	Consumer Credit Legal Centre (NSW) Inc
CEO	Chief executive officer
CFO	Chief financial officer

CFPL	Commonwealth Financial Planning Limited
COAG	Council of Australian Governments
Corporations Act	*Corporations Act 2001* (Cth)
COSL	Credit Ombudsman Service Limited
EDR	External dispute resolution
FCA	Financial Conduct Authority (UK)
FEA	Forest Enterprises Australia
FMA Act	*Financial Management and Accountability Act 1997* (Cth)
FPA	Financial Planning Association
FOFA	Future of Financial Advice
FOS	Financial Ombudsman Service Limited
FSCC	Financial Services Consultative Committee
FSI	Financial system inquiry
FSP	Financial services provider
GFC	Global financial crisis
GPL	Gunns Plantation Limited
GS	Great Southern
GSF	Great Southern Finance Pty Ltd
GSL	Great Southern Limited
GSMAL	Great Southern Managers Australia Limited
HNAB–AG	Holt Norman Ashman Baker Action Group
ICAA	Institute of Chartered Accountants in Australia
IHA	Independent hardship advocate
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ITR	Income tax return
KM	KordaMentha

MIA	*Managed Investment Act 1998*
MIS	Managed investment scheme
MOU	Memorandum of understanding
NAB	National Australia Bank Limited
NFF	National Farmers' Federation
NCCP Act	*National Consumer Credit Protection Act 2009* (Cth)
NZ	New Zealand
OECD	Organisation for Economic Co-operation and Development
PBR	Private binding ruling (ATO)
PDS	Product disclosure statement
PI	Professional indemnity (insurance)
PJCCFS or PJC	Parliamentary Joint Committee on Corporations and Financial Services
POA	Power of attorney
RE	Responsible entity
RG 146	ASIC's Regulatory Guide 146, *Licensing: Training of financial product advisers* (July 2012)
RIRDC	Rural Industries Research and Development Corporation
RIS	Regulation Impact Statement
SME	Small and medium enterprises
SMSF	Self-managed superannuation fund
SOA	Statement of Advice
TFGA	Tasmanian Farmers and Graziers Association
TIMOs	Timberland Investment Management Organisations
TSL	Timbercorp Securities Ltd
UCCC	Uniform Consumer Credit Code
UK	United Kingdom of Great Britain and Northern Ireland

US	United States of America
UTS	University of Technology, Sydney
WFL	Willmott Forests Limited

Preamble

In 2009, two of Australia's largest agribusiness managed investment schemes (MIS) failed—Timbercorp and Great Southern. In quick succession, a number of other major schemes collapsed, including Willmott Forests Ltd and Gunns Plantation Ltd.

Long after their downfall, the sad legacy of the failed schemes continues.

For the purposes of this inquiry, the committee is concerned primarily with retail investors caught up in these schemes, many of whom were first time investors and not highly literate in financial matters. When the agribusiness schemes collapsed, many investors lost not only their investment and prospects of future income but were saddled with the burden of repaying the loans they took out to fund their venture and the interest accruing on a now valueless asset. Indeed, evidence before the committee is riddled with stories of the shattered lives of people who invested, and borrowed to invest, in agribusiness MIS—separation, broken relationships, lost life savings, bankruptcy, ruined health, depression, self-harm and families placed under enormous stress.

The causes for this financial failure on such a large scale were many and varied, and all participants in the industry must bear some responsibility for it. They include: the product manufacturers and promoters; the experts who rated the schemes; the financial advisers who recommended the investments; the finance companies, credit assistance advisers and lenders that facilitated and provided the loans; the regulators and governments for their lack of decisive action in monitoring the marketing and performance of these schemes; and retail investors enticed to enter into highly speculative ventures on borrowed money.

In this report, the committee examines the role of all parties involved in MIS, including those responsible for the policy and regulatory framework in which the schemes flourished and withered, with the intention of identifying measures that could be taken to help protect retail investors from any similar financial debacle in the future.

Explanation—terms of reference

The terms of reference for the committee's inquiry clearly specified that the committee was to inquire into the structure and development of forestry managed investment schemes. Many of the people who made submissions to the inquiry had invested in agribusiness managed investment schemes that included both forestry and horticultural schemes. Furthermore, the two major scheme operators—Timbercorp and Great Southern—were involved in ventures that covered not only forestry managed investment schemes but more broadly agricultural schemes such as olives, almonds, macadamias, stone fruit, citrus, mangoes, avocadoes and table grapes. Because of this cross-over and the similarities in complaints about the promotion and operation of these various schemes, the committee resolved that it would receive submissions that dealt with both forestry and horticultural schemes. They are known collectively as agribusiness managed investment schemes (MIS).

Executive summary

> We are in a living hell. To work your entire life to pay for your home and now lose it.[1]

Agribusiness managed investment schemes (MIS) were developed to finance agricultural operations on a large scale. They allow small investors to pool their funds to invest in a large-scale agricultural operation. MIS were introduced to Australian investors after the passage of the *Managed Investments Act 1998*, ostensibly to encourage agricultural diversification, after the decline of the local forestry industry.

Over the 20-year life cycle of a typical MIS, investors would pay fees in the first few years as orchards were planted, which would become significant tax deductions. Fees would drop after a few years, and the scheme would return profits as the products were harvested in the latter years. MIS quickly became an attractive new tax deduction for wealthy investors, but in a few short years, demand for the deductions grew, and the nature of the industry changed rapidly, to the point where it is best described as an abhorrent 'Ponzi scheme'.

People of all ages and from all walks of life were encouraged to become investors and, more pertinently, to borrow to invest in agribusiness MIS. As a group, many investors, known as growers, bore the brunt of massive losses after the failure of a number of these schemes.[2] Importantly, not all growers could be characterised as sophisticated investors. In fact, a number were retail investors entering into complex borrowing arrangements to finance a speculative venture. They clearly identified themselves as inexperienced investors—'just average hardworking Australians' trying to achieve financial security for the future. Some were single; some had young families; while others were approaching or already in retirement and merely looking for a stable and safe income stream.

When the schemes collapsed, many of these investors lost not only their investment and prospects of future income but were also saddled with the burden of repaying the loans and interest on a valueless asset.

The stories of financial loss and personal anguish retold in this report do not adequately convey the deep pain and suffering endured by many of the growers who invested in MIS that eventually folded. Some struggled to put together their submission because re-living the financial and personal distress was 'extremely confronting', while others could not rouse the energy and have remained silent.[3]

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1 Name withheld, *Submission 162*.

2 See Clarendon Lawyers, Submission to CAMAC, Managed Investment Schemes, paragraphs 3.2.2 and 3.2.3.

3 See, for example, Mr Bernard Kelly, *Submission 117*, p. 1.

Tax incentive

For tax reasons, many agribusiness schemes were structured so that investors were described as operating this investment in their own right. Thus, an agribusiness MIS is a tax effective investment vehicle.

It should be noted, however, that many investors who wrote to the committee indicated that the broad assertion about the tax concessions driving their decision to invest was too simplistic. For them, the tax benefit was only part of their reason for investing in an agribusiness MIS and definitely not the compelling reason. Certainly, not all growers were simply looking for a way to minimise their tax. Many submitters provided information on their annual income, which could only be described as modest—they were not high-wealth individuals.

While the tax advantage may not have been the primary consideration for some investors, it was a factor and certainly a major part in the marketing strategy for the various MIS products. But even investors primarily motivated by the tax advantages were entitled to sound financial advice that was appropriately tailored to their particular circumstances. There has been no suggestion that growers acted illegally in taking advantage of the tax concessions.

Geared investments

It was not unusual for growers to borrow up to 90 per cent of the value of their investment or gear their entire investment in MIS. Even those who clearly indicated that they were not in a strong financial position were encouraged to borrow.

Typically, the loan arrangement was based on the assumption that the project would be cash flow negative for the first few years, then subsequent harvest proceeds would become cash flow positive, which could then be used to pay down the loan.[4] Investors had no reason to be concerned that they would default on their repayments because of assurances that the cash flow from the harvest would pay off the loan and eventually produce a reliable and secure income stream.[5]

A number of investors not only borrowed substantial sums of money but found themselves in a debt trap of having to take out additional loans for annual fees. In this regard, it would appear that the practice of re-financing loans to pay for maintenance and other expenses was commonplace and forced some growers further into debt.[6]

4 There are numerous accounts of investors being led to believe that the scheme was designed to be initially cash flow negative with harvest proceeds then kicking in to become cash flow positive. See, for example, name withheld, *Submission 76,* p. 1; *Confidential Submissions 59,* p. 1; *Confidential Submission 155,* p. 2; *Confidential Submission 164,* p. [1].

5 See, for example, name withheld, *Submission 94,* p. [2].

6 *Submission 101,* p. [1]; name withheld, *Submission 131; Confidential Submission 156,* p. [4].

Some claimed that they did not understand that the yearly management costs would become additional loan commitments 'to sustain the overall investment'.[7]

Finally, many of the borrowers suggested that they did not fully comprehend the loan arrangements and assumed that the loan was held against the actual investment with liability limited to the trees or plants. The loans, however, were 'full recourse' and borrowers were personally liable for their outstanding debt. Thus the anguish and financial loss suffered by those who had invested in the failed schemes was compounded many times over by the loans they took out to fund their venture. The prospect of having to sell the family home to pay off their loan had never entered their minds.

Many of the investors argued that they should never have been granted the loan: that their financial circumstances indicated that the repayments were beyond their means. They argued that had they been fully informed of their loan arrangements they would never have entered into such an agreement and asked where was the lender's responsibility for due diligence.[8]

New credit laws

It is important to note that loans made for the purposes of investment (other than for investment in retail property) are not covered by either the legislative protections of the Uniform Consumer Credit Code (UCCC) or new credit laws introduced in 2010.[9]

Financial advisers and trust

This report abounds with accounts of investors following the recommendations of their adviser whom they genuinely believed was a professional: an expert who would act in their best interests irrespective of incentives that might influence that advice.

But the committee has established that there were horrifying deficiencies in the way some advisers adhered to the basic requirements to know their client, the product they were recommending and to have a reasonable basis for their advice. Evidence indicates that, in some cases, advisers disregarded their clients' risk profiles; withheld important information, particularly about the speculative nature of the venture; failed to provide critical documents; wilfully downplayed risks; and exaggerated the promised returns. There were many claims that the tax deductibility of the schemes somehow equated to a government endorsement or guarantee.

Some financial advisers or accountants put their own interests above those of their clients and gave unsound advice, which resulted in their clients sustaining substantial financial losses. In case after case presented to the committee, it was clearly evident

7 *Confidential Submission 30*, p. [2].

8 *Submission 44*, pp. 3–4.

9 *Submission 34*, paragraphs 112–116.

that some advisers were more intent on selling a product because of the attractive commissions they could earn rather than providing their clients with appropriate advice.

Product producers

Financial advisers, however, were only one component in the promotion and selling of MIS. They relied on marketing material provided by the product manufacturers and were often part of a larger public relations campaign to entice investors into the schemes. In some instances, advisers may have misled their clients, sometimes inadvertently, sometimes deliberately, as they themselves may not have understood or appreciated the pitfalls of the products they were promoting.

The producers of agribusiness MIS must then bear some responsibility for the marketing of these speculative ventures to retail consumers. Without doubt, the evidence supports the contention that retail investors need robust consumer protection and, in the case of agribusiness MIS, the current reliance on disclosure—product disclosure documents (PDSs) and statements of advice (SOAs)—is woefully inadequate. When considering any regulatory change, it is imperative that the government and regulator take close account of the evidence presented by investors to this inquiry that:

- retail investors have difficulty deciphering the information contained in disclosure documents (PDSs and prospectuses) and do not adequately comprehend the significance of the risks being presented (or disguised) in these documents;
- small investors place the utmost trust in their adviser's recommendations—they do not always read information contained in key disclosure documents and rely on their adviser to interpret this material for them;
- despite statutory obligations, advisers and product issuers clearly do not always act in the best interests of their clients and may deliberately withhold, conceal or downplay important information—in the case of agribusiness MIS, some appeared to have conveyed false impressions, for example, by intimating that the schemes were government approved and presenting overly optimistic predictions; and
- important information contained in glossy brochures, prospectuses and PDSs, and sometimes cited during promotional or 'educational' seminars, do not necessarily help investors understand the product and its risks and often serve to obscure rather than inform.

Put bluntly, people unfamiliar with investment matters went to specialists for expert advice: they relied on these professionals to inform and advise them on decision-making. Given the findings of behavioural economics and ASIC's own surveys, the committee recognises that oral advice from a trusted adviser will tend to prevail over information, including on risk, contained in a disclosure document. Of course, this recognition does not downplay the responsibility of product manufacturers and issuers to ensure that the information in their promotional material and disclosure documents is accurate. In fact, it underscores the importance of PDSs doing what they are intended to do—help consumers compare and make informed choices about financial products. There is no doubt that disclosure documents could be clearer and easier to comprehend but the marketing techniques employed by the product issuer and an adviser's interpretation of the documents may drown out warnings about risk in these documents.

There is a persuasive argument that high risk agribusiness schemes should not have been marketed to retail investors. Indeed, the Financial Planning Association (FPA) described agribusiness MIS as 'particularly complex' products…'at the higher end of the risk spectrum' and with a 'particularly complex financing arrangement'. It indicated that:

> Many of our members have related to us that forestry and agribusiness MIS are so difficult to understand and justify as an investment option over alternative products that their licensees do not include them on their approved product lists and financial planners avoid them. Professional indemnity insurers likewise have begun to exclude such products from their policies, as a response to the perceived risk and opacity of the investment case for MIS recommendations.[10]

Yet agribusiness MIS were marketed and sold to unwary investors who had not been properly informed of, or understood, the complexity, or inherent high risk of their investment or loan. As noted earlier, they were retail investors relying heavily on the advice of their advisers and who, on their own admission, had limited capacity to understand or appreciate the risks posed by the investment.

There can be no doubt that much stronger measures are needed to protect retail investors from the promotion and marketing of high risk financial products. A number of inquiries, including the committee's 2014 inquiry into the performance of the Australian Securities and Investments Commission (ASIC) and the Financial System Inquiry (FSI) have mounted a compelling argument for ASIC to have greater powers to intervene in the marketing of financial products. The agribusiness MIS provided just one example of where improved regulation could have prevented many unsuspecting investors from entering into unsafe financial arrangements.

While improved financial literacy is to be encouraged, it would only go part of the way to protecting consumers from investing unwittingly in risky products such as agribusiness MIS. As one witness observed, 'consumers are pitched against the resources and ingenuity of people with the knowledge and wherewithal to outwit them'. Thus, while improved disclosure and education are necessary, they must be accompanied by other measures. The committee has made recommendations that would place obligations on product issuers and research houses to act responsibly in the promotion and marketing of MIS.

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10 *Submission 161*, p. 7.

In its 2014 report on the performance of ASIC, the committee raised particular concerns about banned advisers, or advisers who had been dismissed for misbehaviour, continuing in other roles in businesses providing financial advice. Evidence before this inquiry gives further weight to the call for increased and expanded powers to prevent unscrupulous and unethical advisers from practicing in the industry. In the committee's view, there can be no excuse for not taking stronger action against advisers engaging in egregious conduct and those already banned from providing financial advice.

Liquidation

The liquidators winding up agribusiness MIS have encountered many practical difficulties that were not contemplated by current legislation and exposed the complexities in untangling the rights and obligations of the various parties. It is clear that legislative change is required: that this area of the law is in need of reform.

In this regard, the committee is strongly of the view that the valuable work produced by the Corporations and Markets Advisory Committee (CAMAC) on MIS in 2010, especially the very difficult problems of dealing with MIS companies in financial stress, provides an ideal starting point for reform.

Future of agribusiness MIS

The failure of a number of high profile agribusiness MIS has caused significant damage to investors, farmers, neighbouring communities and the reputation of agribusiness MIS. There was no single cause for their failure but a combination of factors including high upfront costs (sizeable commissions to financial advisers, funds diverted into the general working capital of the parent company, excessive overspending on administration and marketing); poor management decisions regarding the planting and location of the schemes; a business structure that depended too heavily on new sales for cash flow; and the lag time between initial investment and dividends. In addition, the effective implementation of the policy applying to agribusiness MIS was undermined by:

- poorly managed implementation of the policy objective;
- inadequate tracking of, and reporting on, project performance resulting in poor quality information available to investors and policy makers; and
- poor monitoring and understanding of the tax incentives and whether they were having unintended adverse effects, such as investment in non-commercially viable products.

The MIS structure has a number of advantages, particularly the pooling of investment funds to achieve economies of scale. Should the government determine that agribusiness MIS warrant continued government support, then important lessons must be drawn from the failures.

First and foremost, policy makers must have before them solid research on the effects of tax incentives to ensure they do not produce adverse unintended consequences.

Enforcement

Finally, the committee has made recommendations to strengthen ASIC's powers in order to provide more robust investor protection measures by enhancing and expanding banning powers and conferring the power to intervene in the marketing of products. But, for some time, the committee has been concerned about ASIC's slow and inadequate response to use the powers it already has. Should the government proceed to implement the FSI and the committee's recommendations, the onus rests squarely on ASIC's shoulders to exercise its powers accordingly.

In the committee's view, ASIC must ensure that it uses its powers to expose misconduct and brings the full weight of the law to bear on wrong-doers in the financial services industry. It is also important that the penalties for breaching the corporation laws match the seriousness of the offence; recognise the harm it has caused; and provide a strong deterrence.

Findings and recommendations

Removing misconception about government endorsement of schemes

It would appear that some product issuers and financial advisers allowed, or even encouraged, investors to assume that an Australian Taxation Office (ATO) product ruling meant that the government was vouching for the commercial viability of the scheme. There was a similar misunderstanding that ASIC was giving its support to the schemes. Thus, growers mistakenly formed the view that the products had ATO and ASIC approval and considered the various schemes safe and suitable for retail investors.

Recommendation 1 **paragraphs 4.49–4.50**

The committee recommends that the ATO undertake a comprehensive review of its product rulings to obtain a better understanding of the reasons some investors assume that an ATO product ruling is an endorsement of the commercial viability of the product. The results of this review would then be used to improve the way in which the ATO informs investors of the status of a product ruling.

The committee recommends that the ATO and ASIC strengthen their efforts to ensure that retail investors are not left with the impression that they sanction schemes, including the use of disclaimers prominently displayed in disclosure documents including PDS.

Future of Financial Advice reforms

The committee recognises that the Future of Financial Advice (FOFA) reforms may well have remedied one of the most pernicious incentives underpinning poor financial advice—commissions. The evidence clearly highlights, however, the importance of ensuring that there are no loop-holes in this legislation that would allow any form of incentive payments to creep back into the financial advice industry.

Recommendation 2 **paragraph 7.51**

The committee recommends that ASIC be vigilant in monitoring the operation of the FOFA legislation and to advise government on potential or actual weaknesses that would allow any form of incentive payments to creep back into the financial advice sector.

Accountants/tax agents providing financial advice

In light of the evidence and the concerns expressed about possible conflicts of interest and blurring of responsibilities in situations where a tax agent provides financial advice, the committee is convinced that this area of financial advice should be reviewed, particularly advice on borrowing. Clearly, there are important lessons to be learnt from the experiences of retail investors who acted on advice from their accountants or tax agent and invested in MIS.

Recommendation 3 **paragraph 7.67**

While noting the 1 July 2016 expiry of the 'accountants' exemption' under Regulation 7.1.29A of the Corporations Regulations 2001, the committee recommends that the Treasury look closely at the obligations on accountants or tax agents providing advice on investment in agribusiness MIS (or similar schemes). The intention would be to identify any gaps in the current regulatory regime (or the need to tighten-up or clarify regulations) to ensure retail investors are covered by the protections that exist under FOFA and that the level of regulatory oversight of tax agents or accountants providing advice on agribusiness MIS (or similar schemes) does not fall short of that applying to licensed financial advisers.

Financial literacy

ASIC provided the committee with examples of its efforts to lift the standard of financial literacy in Australia. The committee has made recommendations that would place obligations on product issuers and research houses to act responsibly in the promotion and marketing of MIS. Much more, however, is required to provide investors with the information needed to protect their own interests. The committee recognises that improved financial literacy will go some way to help consumers make informed decisions.

Recommendation 4 **paragraphs 8.8–8.9**

The committee agrees with the view that financial literacy has 'got to get aggressive' and recommends that the Australian Government explore ways to lift standards. In particular, the government should consider the work of the Financial Literacy Board in this most important area of financial literacy to ensure it has adequate resources.

Drawing on the lessons to be learnt from the evidence on the need to improve financial literacy in Australia, the committee also recommends that the Australian Government in consultation with the states and territories review school curricula to ensure that courses on financial literacy are considered being made mandatory and designed to enable school leavers to manage their financial affairs wisely. The course content would include, among other things, understanding investment risk; appreciating concepts such as compound interest as friend and foe; having an awareness of what constitutes informed decision-making; being able to identify and resist hard sell techniques; and how to access information for consumers such as that found on ASIC's website. Financial literacy should be a standing item on the Council of Australian Governments' (COAG) agenda.

Culture in the financial services industry

The committee notes that a code of ethics was one of the government's proposed legislative amendments to raise financial advisers' standards. In light of the evidence demonstrating that integrity issues were at the heart of some of the poor financial advice given to MIS investors, the committee highlights the importance of establishing such a code of ethics and suggests that this measure warrants close and determined attention.

Recommendation 5 paragraph 8.28

The committee recommends that the government give high priority to developing and implementing a code of ethics to which all financial advice providers must subscribe.

Banned or unscrupulous advisers

In its response to the FSI report, the government indicated its intention to develop legislation allowing ASIC to ban individuals in management roles within financial firms from operating in the industry. The committee welcomes this move but, to underline the importance of removing opportunities for a banned financial adviser to resurface in other roles in the industry, the committee considers that the term 'management' may be too narrow. Thus, in light of the findings of this committee in two previous reports and of the FSI, the committee reinforces two recommendations it made in June 2014.

Recommendation 6 paragraph 8.45

The committee recommends that the government consider the banning provisions in the licence regimes with a view to ensuring that a banned person cannot be a director, manager or hold a position of influence in a company providing a financial service or credit business.

Recommendation 7 paragraph 8.46

The committee recommends that the government consider legislative amendments that would give ASIC the power to immediately suspend a financial adviser or planner, subject to the principles of natural justice, where ASIC suspects that the adviser or planner has engaged in egregious misconduct causing widespread harm to clients.

Disclosure documents

The inadequacy and complexity of MIS disclosure documents and accompanying advice has been of long-standing concern. Agribusiness MIS are complex products and difficult to understand. Disclosure documents—prospectuses, PDSs and Statements of Advice (SOAs)—proved inadequate in alerting consumers to the risks of investing in agribusiness MIS. The inadequacies in the disclosure together with poor financial advice and slick promotional strategies created an environment unsuited to informed and considered decision-making.

The evidence underscores, as noted previously, the importance of PDSs doing what they are intended to do—help consumers compare and make informed choices about financial products.

Recommendation 8 **paragraphs 9.77–9.80**

The committee recommends that, based on the agribusiness MIS experience, the Australian Government consult with industry on ways to improve the presentation of a product's risks in its respective PDS. The intention would be to strengthen the requirements governing the contents and presentation of information, particularly on risks associated with the product. This measure should not result in adding to the material in these documents. Indeed, it should work to further streamline the contents but at the same time focus on information that an investor requires to make an informed decision with particular attention given to risk.

With this objective in mind, the committee also recommends that the government consider expanding ASIC's powers to require additional content for PDSs for agribusiness MIS.

The committee recommends further that ASIC carefully examine the risk measures used in Europe and Canada mentioned by the FSI and prepare advice for government on the merits of introducing similar measures in Australia.

In conjunction with the above recommendation, the committee recommends that the government consider the risk measures used in Europe and Canada mentioned by the FSI to determine whether they provide a model that could be used for Australian PDSs.

General advice provided during promotional events

The committee welcomes the government's undertaking to replace the term 'general advice' with a term that clarifies the distinction between product sales and financial advice. It is not convinced, however, that renaming the term, in and of itself, provides adequate consumer protection particularly in circumstances where the product producer uses seminars and dinners to promote the product. The committee heard numerous accounts of growers, who attended seminars or promotional dinners, being encouraged to sign up to invest in agribusiness MIS. It has highlighted the role that investment seminars had in influencing investors and is particularly concerned about the way in which scheme promoters used high pressure or hard sell techniques during so called public 'information' or 'educational' sessions. This advice would be classified as general advice.

In the highly charged environment around information sessions, there should be clear obligations on the promoters engaging in this type of marketing to ensure that potential investors are made fully aware of the risks carried by the product they are promoting. Investors must have access to full and accurate information about the product and be discouraged from signing up before receiving independent financial advice—that is receiving personal advice with all the attendant regulatory safeguards. Worryingly, however, the committee notes occasions where the financial adviser was very much part of the promotional team.

Recommendation 9 **paragraph 10.21**

The committee recommends that the government consider not only renaming general advice but strengthening the consumer protection safeguards around investment or product sales information presented during promotional events.

Recommendation 10 **paragraph 10.22**

The committee recommends that ASIC strengthen the language used in its regulatory guides dealing with general advice. This would include changing 'should' to 'must' in the following example:

> **You <u>must</u> take reasonable steps to ensure that the client understands that you have not taken into account their objectives, financial situation or needs in giving the general advice.**

Recommendation 11 **paragraph 10.25**

In light of the concerns about the lack of understanding of the role that referral networks had in selling agribusiness MIS without appropriate consumer protections, the committee recommends that the government's consideration of 'general advice' also include the role of referral networks and determine whether stronger regulations in this area are required.

Research houses experts' reports

The committee acknowledges that there are numerous participants who offer products or services within the financial advice value chain that influence, directly or indirectly, consumers' decisions on financial matters. It particularly notes that research houses and subject matter experts produce reports containing important information for financial advisers and investors in agribusiness MIS. Generally, such information is attached to, or included in, disclosure documents including PDSs. Under the user pays model, however, the experts' opinions may be biased by the remuneration offered by the product issuer and the promise of further business. In the committee's view, research houses and experts providing opinions should be held to high standards of honesty and integrity. In this regard, the committee notes the relevant International Organization of Securities Commission's (IOSCO) statement of principles governing integrity and ethical behaviour and is of the view that they should apply and have force in Australia.

The committee is concerned that the message about compliance and adherence to high ethical standards is not reaching all participants in the industry.

Recommendation 12 **paragraph 10.52**

In respect of research houses and subject matter experts providing information or reports to the market on financial products such as agribusiness MIS, the committee recommends that the government implement measures to ensure that IOSCO's statement of principles governing integrity and ethical behaviour apply and have force. In particular, the committee recommends that the government consider imposing stronger legal obligations on analysts, and/or firms that

employ analysts to rate their product, to act honestly and fairly when preparing and issuing reports and applying ratings to a financial product.

Role of the banks

The committee is firmly of the view that the banks that financed investor loans through the financing arm of both Timbercorp and Great Southern cannot outsource their responsibilities for allowing borrowers to enter into unsafe loans. Even though the banks were not directly involved in arranging the loans and can legally distance themselves from the loan arrangements, they absolutely owed a duty of care to borrowers. As such, the committee contends that the banks, or liquidators with the banks' support, should, as a gesture of good-will, extend to those borrowers special consideration in resolving their outstanding debts.

The committee is disappointed that an apparent adversarial mind-set is undermining the work of the independent hardship advocate (IHA), which was appointed by the liquidator of Timbercorp, KordaMentha. Despite this initiative, the Holt Norman Ashman Baker Action Group (HNAB–AG), a collection of investors who received advice from Mr Peter Holt or his associates, continues to raise complaints against the IHA. The engagement of the advocate had the potential to defuse the confrontational and ultimately damaging relationship that had developed between the liquidator and this group of borrowers. The committee takes the view, however, that despite falling far short of HNAB–AG's expectations, the work of the IHA still offers a more productive way to resolve long-standing disputes over unpaid loans.

Recommendation 13 **paragraphs 11.63–11.64**

The committee recommends that KordaMentha continue, through its hardship program, to resolve expeditiously outstanding matters relating to borrowers who are yet to reach agreement on repaying their outstanding loans from Timbercorp Finance.

The committee recommends that spokespeople for HNAB–Action Group consult with KordaMentha and the independent hardship advocate on implementing measures that would help to restore confidence, faith and good-will in the hardship program.

Recommendation 14 **paragraph 11.78**

The committee recommends that Bendigo and Adelaide Bank support the appointment of an independent hardship advocate to assist borrowers resolve their loan matters relating to Great Southern.

Regulation around investment lending

Investment lending has been instrumental in causing significant financial loss to retail investors who borrowed to invest in agribusiness MIS. In the committee's view, the responsible lending obligations imposed on brokers and lenders through the new credit laws should apply equally to the promoters, advisers and lenders involved in providing funds for investment purposes. The committee has no desire to stifle funding for investment, but to put an end to situations where retail investors are unwittingly entering into unsuitable loan arrangements. The committee is particularly concerned about consumers being encouraged to take out 'full recourse' loans, which means that, in the case of default, the lender can target assets not used as loan collateral. Evidence presented to the committee shows that, in many cases, investors did not realise that if their investment failed to generate the anticipated returns or failed completely, they would need to meet repayments from other sources and could be at risk of losing their home.

The committee is also extremely troubled by the numerous accounts of growers signing over a power of attorney to their adviser to arrange and refinance loans. Clearly, there was a serious breakdown in communication with growers unaware not only of the risky investment venture but of the high risk loan agreement they entered.

These glaring gaps identified in the regulatory framework around credit laws mean that retail investors borrowing to invest are not covered by the responsible lending obligations. The committee formed the view that this situation needs to be remedied. The consultation process, which commenced with the release of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, would provide an ideal starting point for reform and should include recourse loans for agribusiness MIS. The committee understands a referral of legislative power from the states and territories would be required.

Recommendation 15 paragraph 11.92

The committee recommends that the Australian Government initiate discussions with the states and territories on taking measures that would lead to the introduction of national legislation that would bring credit provided predominantly for investment purposes, including recourse loans for agribusiness MIS, under the current responsible lending obligations. The provisions governing this new legislation would have two primary objectives in respect of retail investors:

- **oblige the credit provider (including finance companies, brokers and credit assistance providers) to exercise care, due diligence and prudence in providing or arranging credit for investment purposes; and**
- **ensure that the investor is fully aware of the loan arrangements and understands the consequences should the investment underperform or fail.**

Recommendation 16 paragraph 11.93

The committee recommends that the Australian Government consider ways to ensure that borrowers are aware that they are taking out a recourse loan to finance their agribusiness MIS and also to examine the merits of imposing a maximum loan-to-valuation limit on retail investors borrowing to invest in agribusiness MIS.

Recommendation 17 paragraph 11.94

The committee recommends that the Banking Code of Conduct include an undertaking that the banks adhere to responsible lending practices when providing finance to a retail investor to invest. This responsibility would apply when the lender is providing finance either directly or through another entity such as a financing arm of a Responsible Entity.

Legal advice causing harm

Some investors took legal advice to cease repayments on their MIS loans and are now faced with a loan substantially greater than at the time their schemes collapsed. The committee is concerned that vulnerable people who joined class actions expecting, in effect, to have their loans nullified are now in a financial position far worse than when the class actions started.

The committee is firmly of the view that the legal profession has the responsibility to inform itself of the circumstances around the advice provided to retail investors in collapsed agribusiness MIS to cease repayments on their outstanding debts. The profession needs to act to ensure that it maintains high ethical standards and its members adhere to best interest obligations towards their clients.

Recommendation 18 paragraphs 12.15–12.16

The committee recommends that the Victorian Legal Services Commissioner and Legal Services Board thoroughly review the conduct of the lawyers who provided advice to retail investors in collapsed agribusiness MIS to cease repayments on outstanding debts and the circumstances around this advice.

The intention would be to determine whether the profession needs to take measures to ensure it maintains high ethical standards and that its members adhere to best interest obligations towards their clients. The investigation would include making recommendations or determinations on:

- **remedies available to investors belonging to the class actions who have suffered considerable financial loss as a result of following advice to cease repayments on their outstanding loans;**
- **whether disciplinary action should be taken against the lawyers who provided the advice to stop repayments;**
- **whether the matter warrants any form of compensation; and**
- **whether the matter should be referred to any appropriate disciplinary body.**

Penalties

There can be no doubt that much stronger measures are needed to protect retail investors from the promotion and marketing of high risk products. A number of inquiries, including the committee's 2014 inquiry into the performance of ASIC and the FSI, have mounted a compelling argument for such action. Agribusiness MIS are a clear example where, based on the evidence before the committee, disclosure was inadequate; information was confusing rather than instructive for retail investors; and oral advice either misinterpreted the disclosure documents, downplayed risks, or selectively presented positive messages. Clearly, improved regulation could have prevented many unwary investors from entering into unsafe financial arrangements.

The committee is of the view that Australia's financial services regulatory regime, with its focus on disclosure, has not served Australian investors well and has not provided a reasonable level of consumer protection. While improved disclosure and education are necessary, they must be accompanied by other measures. Attention must be given to product issuers and their obligation to act in the best interests of investors.

The committee welcomes the government's endorsement of the FSI's recommendation to confer on ASIC a product intervention power. The committee understands that penalties commensurate with the offence are needed to send a strong message to product issuers to act responsibly when marketing products to retail investors. Indeed, in light of the FSI and ASIC's observation regarding the importance of having higher penalties, the committee formed the view that the government should consider increased penalties for serious breaches.

Recommendation 19 **paragraph 14.47**

To augment ASIC's product intervention power, the committee recommends that the government review the penalties for breaches of advisers and Australian Financial Services Licensees' obligations and, under the proposed legislation governing product issuers, ensure that the penalties align with the seriousness of the breach and serve as an effective deterrent.

Liquidation of agribusiness MIS

Evidence before this committee has highlighted the complicated task of untangling the interests of the various parties affected when an MIS gets into financial difficulties and ultimately fails. In this regard, it should be noted that in November 2010, the government commissioned CAMAC to undertake a review of the current statutory framework for all MIS. The subsequent report was comprehensive and produced a range of well-considered and practical proposals for reform under the current legal framework and, in addition, set out an alternative legal framework for the regulation of schemes.

Recommendation 20 **paragraph 15.51**

The committee recommends that the government use CAMAC's report on managed investment schemes as the platform for further discussion and consultation with the industry with a view to introducing legislative reforms that would remedy the identified shortcomings in managing an MIS in financial difficulties and the winding-up of collapsed schemes.

Taxation incentives for agribusiness MIS

In 2005, the government undertook a review of the taxation policy of plantation forestry and, in 2008, conducted a review into non forestry MIS.[11] Since then, there have been major developments in this area that have exposed flaws either in taxation policy and/or its implementation. Now, with the benefit of hindsight, the committee is convinced that, based on the MIS collapses, it is time to examine the tax incentives and any unintended consequences that flowed from them. In particular, the review should look at the extent to which the tax concessions created distortions.

In this respect, the committee notes, however, the pleas from some quarters of the industry not to 'throw the baby out with the bathwater'.

Recommendation 21 **paragraph 16.40**

The committee notes that neither the ATO nor Treasury have undertaken a comprehensive review of the tax incentives for MIS and whether they had unintended consequences, such as diverting funds away from more productive enterprises; inflating up front expenses; or encouraging poorly-researched management decisions (planting in unsuitable locations). The committee recommends that Treasury commission a review to better inform the policy around providing tax concessions for agribusiness MIS.

Recommendation 22 **paragraph 16.41**

The committee recommends further that the proposed review consider the approach to the incentives offered to investors in agribusiness ventures by other countries such as the United Kingdom to inform the review's findings and recommendations.

Recommendation 23 **paragraphs 16.42–16.43**

In addition to the above recommendation, the committee recommends that the government request the Productivity Commission to inquire into and report on the use of taxation incentives in agribusiness MIS. As part of its inquiry, the Productivity Commission should identify the unintended adverse consequences, if any, that flowed from allowing tax deductions for agribusiness MIS. For example:

- **the potential for mis-selling financial products on the tax concessions;**
- **the incentive for retail investors to borrow, sometimes unwisely, to fund their investment;**

11 In the 2005–06 Budget, the government announced that it would conduct a review of the application of taxation law to plantation forestry in the context of the government's broader plantation and natural resource management policies. Treasury, *Review of Taxation Treatment of Plantation Forestry*, 22 June 2005, http://archive.treasury.gov.au/contentitem.asp?ContentID=997&NavID= (accessed 22 September 2015).

- **whether the taxation concessions:**
  - **became an end in themselves rather than the business model;**
  - **showed up as subsidies to higher cost structures, operations and/or returns to the operators of the schemes; and**
  - **distorted land values and diverted high value farmland into passive monoculture such as Blue Gums.**

The main purpose of the inquiry would be to draw not only on the experiences of the failed MIS but also the successful schemes to determine whether there is merit in reforming the system of tax incentives and, if so, what those reforms should be.

Enforcement

It is important that penalties contained in legislation provide both an effective deterrent to misconduct as well as an adequate punishment, particularly if the misconduct can result in widespread harm. Insufficient penalties, or the failure to apply them, undermine the regulator's ability to do its job. Inadequately low penalties or poor enforcement do not encourage compliance and they do not make regulated entities take threats of enforcement action seriously. In 2014, the committee considered that a compelling case had been made for the penalties currently available for contraventions of the legislation ASIC administers to be reviewed to ensure they were set at appropriate levels. The committee has reinforced this recommendation. But, ASIC must also ensure that it uses its powers to effect in order to send a potent message to all those in the financial services industry that it is serious about exposing misconduct and bringing the full weight of the law to bear on wrong doers.

Recommendation 24 **paragraphs 18.16–18.18**

The committee recommends that ASIC review the complaints made against advisers and accountants, licensed or unlicensed, who engaged in alleged unscrupulous practices when recommending that their clients invest in agribusiness MIS. The review would identify any weaknesses in the current legislation that impeded ASIC from taking effective action against those who engaged in such unsound practices. This review would also examine the adequacy of the penalties available to ASIC to impose on such wrong doers. In particular, ASIC should consider the adequacy of penalties that apply to those who were unlicensed or have since become unlicensed. Banning in such cases is redundant.

The committee also recommends that as part of this review, ASIC consider the practice of advisers using bankruptcy as a means to avoid recompensing clients who have suffered financial loss as a result of their poor financial advice and any possible remedies.

The committee recommends that ASIC provide its findings to the committee.

In this regard, it should be noted that the committee is currently inquiring into the inconsistencies and inadequacies of current criminal, civil and administrative penalties for corporate and financial misconduct or white-collar crime.

Chapter 1

Introduction

1.1 On 25 June 2014, the Senate referred the matter of the structure and development of forestry managed investment schemes to the Senate Economics References Committee for inquiry and report by 27 October 2014. On 2 September 2014, the Senate granted an extension to report by 31 March 2015 and following a number of further extensions to 14 March 2016.

1.2 According to the terms of reference governing this inquiry into forestry managed investment schemes (MIS), the committee was to consider in particular:

- the motivation and drivers that established the framework for the schemes initially;
- the role of governments in administering and regulating forestry MIS;
- the current policy and regulatory framework of forestry MIS;
- the role of some in the financial services industry in promoting and selling forestry MIS;
- compensation arrangements for small investors in forestry MIS who have lost life savings and their homes in the face of the collapse of forestry MIS;
- the burden on farmers and other agricultural producers who have been left with the uncertainty of timber plantations linked to forestry MIS on their land;
- the options for reforming forestry MIS to protect investors and rural communities; and
- any other related matters.

Conduct of inquiry

1.3 The committee advertised the inquiry on its website calling for written submissions. It wrote directly to a range of government departments and agencies, organisations and academics drawing their attention to the inquiry and inviting them to make written submissions. The committee also invited the peak bodies for accountants, financial advisers and the forestry industry as well as other people known to be interested in forestry managed investment schemes to contribute to the inquiry.

1.4 Initially, the committee called for submissions to be lodged by 4 September 2014, but, following the extension of the reporting date, the committee announced it would accept submissions up to 15 December 2014.

1.5 The committee received 201 submissions, many supplementary submissions, and additional information including answers to a series of questions taken on notice by witnesses and responses to specific matters raised in submissions. These documents are listed at Appendices 1 and 2.

1.6 The committee held five public hearings: in Melbourne on 12 November 2014 and 4 and 6 August 2015, in Launceston on 5 August 2015 and in Canberra on 14 October 2015. The committee also undertook a site visit to a property at Birralee Road Westbury, near Launceston.

1.7 A list of the hearings and the names of witnesses who appeared before the committee is at Appendix 3.

Terms of Reference

1.8 The terms of reference for the committee's inquiry clearly specified that the committee was to inquire into the structure and development of forestry managed investment schemes. Many of the people who made submissions to the inquiry had invested in agribusiness MIS that included both forestry and horticultural schemes. Furthermore, the two major scheme operators—Timbercorp and Great Southern—were involved in ventures that covered not only forestry managed investment schemes but more broadly agricultural schemes such as olives, almonds, macadamias, stone fruit, citrus, mangoes, avocadoes and table grapes. Because of this cross-over and the similarities in complaints about the promotion and operation of these various schemes, the committee resolved that it would receive submissions that dealt with both forestry and horticultural schemes. They are known collectively as agribusiness managed investment schemes (hereafter agribusiness MIS).

Background to inquiry

1.9 Although a number of high profile agribusiness MIS failed in 2008, 2009 and 2010—Environinvest group, Timbercorp, Great Southern group, Willmott and Gunns—the consequences of their collapses are still reverberating. After years of uncertainty and financial loss, many small investors currently face the prospect of even further hardship. Not only have they lost their original investment but a number now find they are required to repay significant loans. Moreover, additional information is still coming to light about the promotion and selling of these products. Indeed, recent years have exposed an aspect that has not yet been fully investigated—the financing arrangements that allowed growers to invest in these schemes, with many unwittingly committing themselves way beyond their financial means.

1.10 Some farmers who leased their land to MIS are also suffering financial loss from failed MIS and seeking clarity on their legal position with regard to ownership rights over land and trees and liability for damage. The administration and liquidation of MIS has given rise to a number of difficulties again associated with ownership rights but also with conflicts of interest.

1.11 Since the collapses, significant reforms have been introduced that address some of the problems associated with the schemes, particularly the provision of poor financial advice. They include the Future of Financial Advice (FOFA) reforms, which have introduced robust measures to strengthen consumer protection, such as the banning of conflicted remuneration and obligations to act in the best interests of clients. Some of these major reforms have not yet fully come into effect, while others are still under active and further consideration. In this regard, the Australian Bankers' Association recently stated that the financial advice industry was in a state of transition:

> The implementation of the Future of Financial Advice (FOFA) reforms, together with industry driven initiatives in relation to financial adviser education and competency have triggered a substantial and structural shift in the financial advice industry.[1]

1.12 During this inquiry, the government also responded to a major report on Australia's financial system indicating its intention to implement further reforms such as conferring a product intervention power on the Australian Securities and Investments Commission (ASIC).

1.13 At a time when reforms to improve consumer protection have been implemented and further changes are contemplated, the committee's inquiry is both timely and necessary. It provides an opportunity to critically evaluate current and proposed reforms and consider whether they would adequately and effectively address the failures in consumer protection exposed by the collapse of agribusiness MIS and the consequent harm to investors.

During the committee's public hearing on 12 November 2014, many investors who had sustained substantial losses due to failed agribusiness MIS, packed the Melbourne Town Hall to hear evidence and lend support to other investors similarly affected by the collapse of the schemes.

1 *Submission 75* to the committee's inquiry into the Scrutiny of Financial Advice, p. [1].

Submissions

1.14 The majority of submissions to the inquiry came from individuals or groups of concerned investors or consumers who wanted to draw the committee's attention to their specific grievance. Often their accounts involved allegations of adviser misconduct that had resulted in significant personal financial loss and sometimes financial ruin.

1.15 The committee was not able to investigate every individual matter that was raised in submissions. Many submitters were hopeful that the committee could assist them to right perceived wrongs. Unfortunately, this was neither possible nor the committee's role. The committee, however, gave great weight to their accounts and experiences: this evidence helped inform deliberations and assisted the committee formulate recommendations.

Confidential material

1.16 The committee prefers to take evidence in public. With this inquiry, however, a number of submitters requested that the committee receive their submission in confidence or withhold publication of their names. In general, the committee respected their wishes. In some cases, and without the submitters' request, the committee itself resolved to receive submissions in camera or to withhold sections from publication. Such decisions were based on a variety of reasons including:

- the matter was still under investigation or consideration by a court or tribunal;
- concern over publicising a person's private circumstances, including personal health matters or those of their immediate family or strained or broken relationships; and
- reluctance to allow a person to be publicly denigrated or embarrassed where their involvement in an alleged offence appeared to be incidental or not relevant to the committee's inquiry.

1.17 Where the committee drew on in camera evidence for its report, it was careful to ensure that such material was used to support information already publicly available or where it had sought verification from other sources.

1.18 In some instances, the committee declined to receive submissions or sections of submissions. The overriding reason in most instances stemmed from the submissions' failure to address the committee's terms of reference. Some submitters were disappointed with the committee's decision either to return their submission or to remove names or sections of their submission before publication. Where information was deemed to be outside the committee's terms of reference, however, the committee could not accept it as evidence to the inquiry.

Adverse comment

1.19 Many people who made submissions felt as though they had been betrayed by advisers in whom they had placed the utmost trust. Clearly, it was important for them to be able to name those whom they believed caused them harm. On the other hand, the committee was aware of the severe and irreparable reputational damage that accountants or advisers could suffer if identified for alleged misconduct or incompetence.

1.20 In the interests of transparency and to enable a thorough public airing of the allegations made about the misconduct of advisers, the committee resolved that where an alleged offence or transgression was already on the public record, it would allow the identity of that adviser to be disclosed. In fairness though, the committee attempted to contact such individuals alerting them to the adverse comment levelled against them and offering them the opportunity to respond.

1.21 In cases where the committee formed the view that the allegations against an adviser were not widely known, it resolved that it would not publish the adviser's identity. This measure was not an attempt to sanitise the evidence but to arrive at an appropriate balance between natural justice and the public's right to know. Although, the committee's interest was in identifying systemic problems with the marketing of agribusiness MIS rather than any particular adviser, it took the opportunity to alert ASIC to any concerns it had about specific individuals.

Scope and structure of report

1.22 Agribusiness MIS have had a chequered history and been the subject of numerous parliamentary inquiries. For example, the high profile collapses of major agribusiness MIS in 2009 prompted the Parliamentary Joint Committee on Corporations and Financial Services to inquire into aspects of such schemes. Two years later, the Corporations and Markets Advisory Committee (CAMAC) conducted its own review of managed investment schemes.

1.23 The committee felt it was important to place the current inquiry in this context. Although the committee took account of the evidence taken by, and the findings of, previous inquiries, it did not seek to re-work ground already well traversed.

Introduction and background to MIS

1.24 This introductory chapter and chapter 2 provide background information on MIS (forestry and non-forestry): their structure, responsibilities and characteristics, with particular reference to the collapse, liquidation and aftermath of Timbercorp, Great Southern, Willmott Forests and Gunns. The report is then grouped into four sections.

Part I—Retail investors and incentives to invest

- Chapter 3 describes briefly, and provides insight into, the harm caused to retail investors through the collapse of agribusiness.
- Chapter 4 examines the MIS' taxation concessions; their promotion; the extent to which they attracted investors; and the ATO's product rulings including the government's perceived endorsement of the product.
- Chapter 5 considers the increased risk to investors when they borrow to invest. It looks at geared investments in agribusiness MIS: the nature of advice on investment lending and loan arrangements; lending practices; full recourse loans and their implications; loan application forms; pressure selling; and responsible lending.
- Chapter 6 focuses on retail investors; behavioural economics; the trust that investors placed in their advisers; and the promotional practices used to entice retail investors to invest in agribusiness MIS.

Part II—Promoters and producers of MIS—advisers, product issuers, ratings experts, lenders and class action lawyers

- Chapter 7 centres on the quality of investment advice and on fees, charges, commissions and marketing techniques. It looks at the conduct of some financial advisers, including accountants who provided poor advice; the factors driving this advice; and recent legislation to remove commissions.
- Chapter 8 considers the importance of recent reforms and, in light of the lessons to be drawn from the collapse of high-profile MIS, whether any further measures are required to strengthen consumer protection. It underlines the role of investors themselves in protecting their interests and then considers enhanced powers to ban unscrupulous advisers from the industry and the overall culture that pervades the financial services industry.
- Chapter 9 explores the role and responsibilities of the product producer toward retail investors, the reliance on disclosure as a means of consumer protection and its effectiveness when it comes to the promotion and selling of agribusiness MIS.
- Chapter 10 expands on the responsibilities and obligations of the product issuer when providing general advice; the marketing strategies involving promotional events; and the role of expert reports and research houses in promoting MIS.
- Chapter 11 contemplates the role of the banks in providing finance through finance companies to investors to fund their agribusiness scheme; due diligence when providing loans; debt recovery, penalty rates, hardship arrangements and the relevance of new credit laws.
- Chapter 12 deals with growers' class actions including advice by lawyers not to repay loans.

Part III—MIS as a commercially viable model and its suitability for retail investors

- Chapter 13 questions the commercial viability of some agribusiness MIS including the business model, the schemes' performance, management and possible structural deficiencies including suggestions that the schemes were ponzi-like structures.
- Chapter 14 turns its attention to the appropriateness of marketing agribusiness MIS to retail investors and whether there is a need to strengthen legislation to protect retail investors from such schemes by placing obligations on the issuer of a product and restricting the market for unsafe products.

Part IV—Winding up failed schemes, compensation for losses and lessons to be learnt

- Chapter 15 deals with the aftermath of MIS collapse; appointing a replacement responsible entity; receivership and liquidation; the functions, responsibilities, obligations of, and difficulties confronting, administrators including disentangling the affairs of related entities and reconciling competing interests.
- Chapter 16 assesses the effects of failed MIS on the environment and on farmers who leased land to such enterprises and, overall, the future for agribusiness MIS in Australia with a particular emphasis on using tax concessions as an incentive to invest.
- Chapter 17 recognises the importance of compensation for people who have suffered loss through the negligence, incompetence or wilful deceptiveness of financial advisers and/or the inappropriate marketing of high risk products to retail investors.
- Chapter 18 underlines the role of the regulator in protecting consumer interests and summarises the key findings of the report.

Acknowledgements

1.25 During the course of the inquiry, the committee benefitted greatly from the participation of many individuals and organisations located throughout Australia. The committee thanks all those who assisted with the inquiry, especially the witnesses who put in extra time and effort to answer written questions on notice and provide valuable feedback to the committee as it gathered evidence.

1.26 But most particularly, the committee acknowledges the many people who wrote to the committee recalling their experiences. They range from whistleblowers, who placed their careers in jeopardy in order to expose corporate wrongdoing, to individuals who found themselves in dire financial circumstances. Without their personal accounts, the committee would not have been able to appreciate fully the need for stronger action to ensure that Australia's financial services regulatory framework is robust and focused on protecting the retail investor and consumer from unscrupulous operators, poor advice and high risk financial products.

Chapter 2

Managed investment schemes

2.1 The passage of the *Managed Investment Act 1998* (MIA) created a framework that allowed for the establishment of an investment structure—a managed investment scheme. This structure replaced the prescribed interest schemes that, up to that time, were widely used as a collective investment mechanism to 'pool' investors' funds.[1]

2.2 The primary object of the MIA was to strengthen investor protection in an era of unprecedented growth in collective investment schemes. The deregulation of financial markets in the 1980s saw a proliferation of collective investment vehicles, from the largest commercial property and management trusts to small one-off schemes such as pine forests, ostrich and yabby farms. The government's support for self-funded retirement, following the introduction of compulsory superannuation in 1992, further stimulated growth in this sector during the 1990s. According to a review of the MIA undertaken in 2001:

> A key driving principle behind the new framework was the shortcoming evident under the dual trustee/fund manager structure of the former [prescribed investment] regime, where it was difficult to determine who was ultimately responsible for a scheme's operation.[2]

2.3 Under the MIA, the managed investment sector continued to expand substantially with new companies forming to offer products to the retail market. In particular, agribusiness MIS grew. In this chapter, the committee examines the structure, responsibilities and operation of agribusiness MIS.

Structure

2.4 As a structure, MIS allows for collective investments that enable a large number of investors (either retail or wholesale) to pool funds, or invest in a common enterprise, for large scale projects.[3] They have the following features:

- people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent, and whether they are enforceable or not);
- contributions are pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders); and

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1 See Alan Cummine, *Submission 146*, p. 7.

2 Commonwealth of Australia, *Review of the Managed Investments Act 1998*, 2001, p. 25.

3 See, for example, Australian Forest Products Association, *Submission 126*, p. 5.

- members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).[4]

2.5 The MIA removed the requirement for an independent trustee. Under this new legislation, a single responsible entity (RE) replaced the dual trustee/fund manager structure of the prescribed interest regime and was directly responsible to scheme members for the scheme's operation. The intention was to avoid the confusion over accountability engendered by the dual trustee/fund manager structure of the previous regime.

Responsible entity

2.6 A registered MIS cannot operate without an RE, which must be a public company that holds an Australian financial services licence (AFSL) authorising it to operate a managed investment scheme.[5] As noted above, investors do not have day-to-day control of the enterprise, rather the RE carries full responsibility for a scheme and any liability for losses. One of the duties of an RE is to hold scheme property on trust for scheme members.[6] As the operator of an agribusinesses MIS, the RE agrees to plant, manage and harvest the product with the harvest proceeds net of outstanding costs and fees returned to the investor.[7] In exercising its powers and carrying out its duties, the RE of a registered scheme must:

- act honestly;
- exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position;
- act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests;
- treat the members who hold interests of the same class equally and members who hold interests of different classes fairly;
- not make use of information acquired through being the responsible entity in order to:
    - gain an improper advantage for itself or another person; or
    - cause detriment to the members of the scheme;

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4 *Corporations Act 2001*, s 9, Definition of managed investment scheme, http://www.comlaw.gov.au/Details/C2014C00519/Download (accessed 15 November 2014).

5 *Corporations Act 2001*, s 601FA.

6 *Corporations Act 2001*, s 601FC(2).

7 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 3, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

- ensure that the scheme's constitution meets the requirements of sections 601GA and 601GB (provisions governing contents of the constitution and legal enforceability of the constitution);
- ensure that the scheme's compliance plan meets the requirements of section 601HA (provisions governing the contents of the compliance plan);
- comply with the scheme's compliance plan;
- ensure that scheme property is:
  - clearly identified as scheme property; and
  - held separately from property of the responsible entity and property of any other scheme;
- ensure that the scheme property is valued at regular intervals appropriate to the nature of the property;
- ensure that all payments out of the scheme property are made in accordance with the scheme's constitution and the Act;
- report to ASIC any breach of the Act that:
  - relates to the scheme; and
  - has had, or is likely to have, a materially adverse effect on the interests of members;

  as soon as practicable after it becomes aware of the breach; and
- carry out or comply with any other duty, not inconsistent with the Corporations Act, that is conferred on the responsible entity by the scheme's constitution.[8]

2.7 It should be noted that these requirements were in force during the period covered by this inquiry.

2.8 An officer of the RE of a registered scheme is under similar statutory obligations to, among other things, act honestly; exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position; and act in the best interests of the members. If there is a conflict between the members' interests and the interests of the RE, the officer is to give priority to the members' interests. Officers of an RE must not make improper use of their position as officers to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme. In addition, officers must take all steps that a reasonable person would take to ensure that the responsible entity complies with the Corporations Act, any conditions imposed on the responsible entity's Australian financial services licence, the scheme's constitution and compliance plan.[9]

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8 *Corporations Act 2001*, s 601FC.

9 *Corporations Act 2001*, s 601FD.

2.9 ASIC informed the committee that, although the legislative framework for MIS has been 'the subject of a number of reviews and a significant amount of work in developing potential refinements', the regime has remained largely unchanged.[10]

Agribusiness MIS

2.10 Agribusiness MIS are essentially a means to finance agricultural operations on a large scale. They allow small investors to pool their funds and to invest in a large agricultural operation that can achieve significant scale. This pooling of investment funds is most beneficial in those agricultural industries where scale is necessary to achieve low cost production.[11] Individual investors then delegate their allotments to a single manager for the efficient operation of the entire scheme. Investor fees provide the scheme manager with the necessary funds to establish and operate the scheme.[12]

2.11 According to the Australian Forest Products Association, the MIS structure proved effective in 'leveraging private sector investment in plantation development' and became a high profile source of investment in rural industries. It suggested that this success was due to schemes being able to:

- provide investment scale through pooling of investments funds;
- provide economies of scale through year-on-year investment in the resource;
- address information deficiencies and lower transaction costs; and
- improve cash flow to help offset high up-front establishment costs.[13]

2.12 During their early years, agribusiness MIS accounted for around $300 million per annum of investment in rural industries—mostly in forestry, viticulture/wine, olives and almonds. Although, a minor source of investment overall, agribusiness MIS have been important in the development of some industries—notably blue gum forestry and olives.[14]

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10 *Submission 34*, paragraph 12.

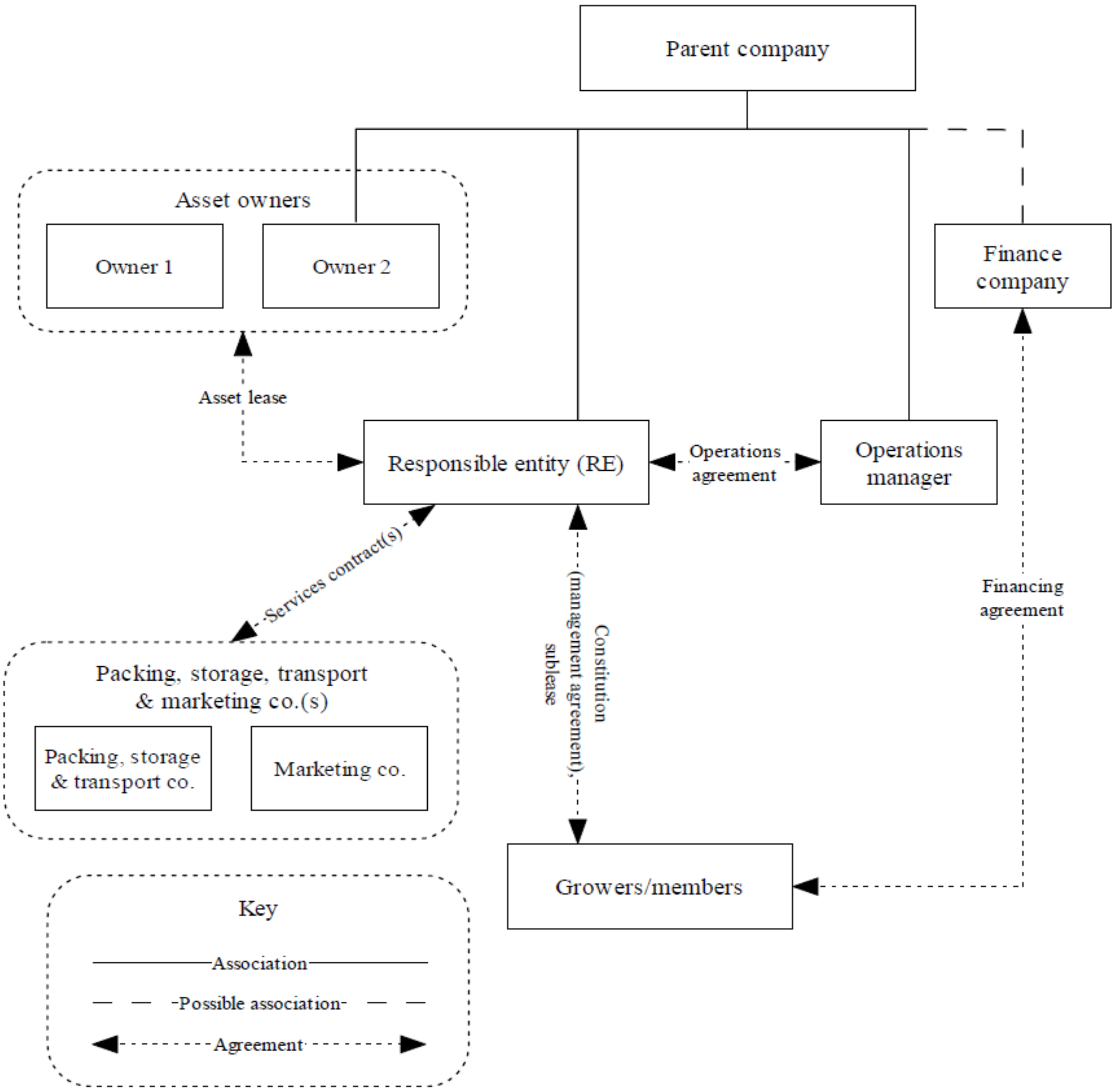
11 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture, with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation (RIRDC), RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, pp. vii, 33, 37, 38 and 48. https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

12 The Treasury, *Review of Non-Forestry Managed Investment Schemes*, Report, December 2008, paragraphs 10 and 65, http://archive.treasury.gov.au/documents/1549/PDF/Review_of_non_forestry_MIS.pdf (accessed 4 December 2014).

13 Australian Forest Products Association, *Submission 126*, p. 6.

14 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture, with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation (RIRDC), RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, January 2006, p. vii.

Figure 2.1: A typical MIS structure[15]



15 Based on Chart 4: A typical MIS structure, The Treasury, *Review of Non-Forestry Managed Investment Schemes*, Report, December 2008, p. 28, http://archive.treasury.gov.au/documents/1549/PDF/Review_of_non_forestry_MIS.pdf (accessed 4 December 2014).

Growers' rights

2.13 By and large, investors in an agribusiness MIS (known as growers) do not own any physical assets, such as the land or trees. The growers' contributions secure them an interest in the scheme, which, in effect, is a bundle of rights over an area of land or allotment. These rights include 'a right to have particular services carried out in a given area of land (such as the establishment and maintenance of trees for growing a crop), and a limited right to the trees and the crop that is grown'.[16] ASIC explained:

> …investors acquire a right to derive profits from agribusiness produce of the agribusiness enterprise (e.g. timber, wine, grapes, olives, and almonds), net of management and lease fees paid to the responsibility entity, and net of rent and other expenses incurred in operating the agribusiness scheme.[17]

2.14 Generally, on entering the scheme, investors assign their rights to the crop to the manager in return for a share of the harvest proceeds. Researchers have noted that:

> Even though the investor may have 'ownership rights' to the trees or crop on a specific acreage, the MIS agreement provides that the harvest proceeds from the whole scheme are shared pro rata among investors according to their relative investments—thereby diversifying risk. [18]

2.15 The Great Southern Plantations 2007 Project was one such scheme. The scheme was registered with ASIC on 8 March 2007, at which time Great Southern Managers Australia Limited (GSMAL) became the RE. Approximately 4,000 growers invested in the scheme which took in 43,989 woodlots of about one third of a hectare each. By May 2009, growers had invested around $132 million in the scheme. The relationship between GSMAL and the growers was defined by a Product Disclosure Statement (PDS), a scheme constitution, the terms of the sub lease and management agreement whereby each grower engaged GSMAL to prepare, establish, maintain and ultimately harvest the trees.[19] According to the Bendigo and Adelaide Bank:

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16 The Treasury, *Review of Non-Forestry Managed Investment Schemes*, Report, December 2008, paragraph 11, http://archive.treasury.gov.au/documents/1549/PDF/Review_of_non_forestry_MIS.pdf (accessed 4 December 2014). See also ASIC, *Submission 34*, paragraphs 39 and 40.

17 ASIC, Regulatory Guide 232, *Agribusiness managed investment schemes: Improving disclosure for retail investors*, January 2012, paragraph RG 232.33, http://download.asic.gov.au/media/1246956/rg232.pdf (accessed 9 June 2015).

18 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 3, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

19 Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq) [2011] VSC 242 (8 June 2011) [7].

> A managed investment scheme was the logical investment vehicle for Great Southern to offer pooled investments in plantation and agricultural projects to investors.[20]

Tax benefits

2.16 For tax reasons, many agribusiness MIS were structured so that investors were taken to operate their agribusiness investment in their own right. Thus, an agribusiness MIS is a tax effective investment vehicle. With this type of scheme, investors can claim a personal income tax deduction for the cost of investing in timber plantation and agribusiness development activities—for the up-front investment and any annual fees paid to the RE and its related parties.[21] According to ASIC, agribusiness schemes were designed around this tax benefit, which is 'received at point of initial investment and then subsequent revenue commencing at a variable time later, such as 4–5 years later when the crops reach maturity'.[22] Although there have been changes to the tax regimes for forestry and non-forestry MIS, the allowable tax deductions are a common characteristic of the schemes.[23]

Financing investment through borrowing

2.17 The provision of finance is a marked feature of agribusiness MIS. While some growers drew on their own funds to finance their investment, many chose to access finance offered through their scheme, which provided finance for growers to make their initial application fee. Repayments were to be made over the life of the loan and fully discharged from the proceeds of the harvest. The scheme allowed an upfront tax deduction of the loan application fee and of interest payments on the loans.

Forestry MIS

2.18 Forestry schemes refer to plantation forestry projects which may be ready to harvest in 8–25 years, necessitating a long period between investment and return.[24] The Australian Forest Products Association noted the significant challenges in attracting private investment into plantation forestry created by the large scale

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20 Bendigo and Adelaide Bank, response to *Submissions 52* et al, dated 24 December 2014, p. [3].

21 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The Changing Landscape of Australia's Forestry Investment Sector', pp. 1–2, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

22 ASIC, *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 62.

23 ATO, answer to written question on notice, No. 2 taken on 14 October 2015.

24 ASIC *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraphs 59–61.

required to achieve a viable resource, the asset's relative illiquidity, high initial costs and long waiting period for return on these long-term ventures.[25]

Plantations 2020 Vision

2.19 In the 1990s, Australia faced a growing trade deficit in wood products.[26] In 1992, the Commonwealth and state governments endorsed a plantation policy contained in the National Forest Policy Statement (1992). Importantly, one of the policy goals was to increase the total area of forest. In this regard, the governments recognised that the long-term nature of plantation investments, often in excess of twenty years, could cause difficulties attracting investment capital as the policy statement explained:

> When capital is committed for such a long time before a return is received, companies, individuals and farmers may be reluctant to invest in plantations.[27]

2.20 Notably, under this policy, the Commonwealth recognised 'pooled development funds' as a useful mechanism for promoting long-term investments, including plantation development, and announced it would encourage the establishment of such funds. Also, taxation was identified as one of the areas that could help minimise impediments to plantation development and assist governments achieve their plantation objectives.[28]

2.21 In July 1996, the Ministerial Council on Forestry, Fisheries and Aquaculture endorsed the plantation industry's target of trebling the plantation estate by the year 2020. To achieve this target, the Ministerial Council agreed, in consultation with relevant stakeholders, to develop a realistic and achievable national strategy. Subsequently, in 1997, *Plantation 2020 Vision* was released. This agreement was a three way partnership involving the Australian, state and territory governments and industry.[29]

2.22 In addition to trebling Australia's plantation estate, one of the strategic gaols of the *2020 Vision* was to have a plantation industry with a sound reputation as a credible investment destination and to have 'well-informed investors' willingly

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25 *Submission 126*, p. 6.

26 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The Changing Landscape of Australia's Forestry Investment Sector', p. 4, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

27 National Forest Policy Statement: A New Focus for Australia's Forests, 2nd edition 1995, pp. 3 and 27, http://www.agriculture.gov.au/SiteCollectionDocuments/forestry/australias-forest-policies/nat_nfps.pdf (accessed 12 January 2015).

28 National Forest Policy Statement: A New Focus for Australia's Forests, 2nd edition 1995, pp. 25 and 27, http://www.agriculture.gov.au/SiteCollectionDocuments/forestry/australias-forest-policies/nat_nfps.pdf (accessed 12 January 2015).

29 Department of Agriculture, *Submission 135*, p. 3.

participate in 'well-run and profitable managed investment plantations projects'.[30] The expectation was that private investment would take on a bigger role in helping to boost the national plantation estate.

2.23 Following the release of the *2020 Vision*, Australia's plantation estate increased significantly to around 2 million hectares by 2008.[31] Mr Alan Cummine, who has extensive experience in the forestry industry, attributed the growth in private plantation after 1997–98 to companies that had been managing 'prospectus-financed' forestry schemes for some years responding positively to the launch of the *2020 Vision*.[32]

Structure of forestry MIS

2.24 Although forestry investment schemes take on different forms, their core activities involve establishing, managing, harvesting, processing and supplying timber products from plantation grown on behalf of shareholders, unit holders and scheme members.[33] For example with the Willmott Group:

> Each investor leased an area on which trees were to be grown. Generally, each investor made a forestry management agreement with a company in the Willmott group, by which that company agreed to plant, maintain and harvest the trees. Most forestry management agreements provided for the investor to pay the relevant company an initial fee, but for the investor to pay no further sum until the trees were harvested.[34]

2.25 Each lease was for a term of years and some leases gave the tenant an option for a further term.[35] The National Association of Forest Industries noted the special characteristics that distinguish forestry MIS, including the significant proportion of the total costs that are incurred during the plantation establishment phase. In this regard, it noted that growers are required to 'wait a long time before any returns on their investments can be realised'. It stated:

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30 *Plantations for Australia: The 2020 Vision*, an industry/government initiative for plantation forestry in Australia, p. 15, http://www.agriculture.gov.au/Style%20Library/Images/DAFF/__data/assets/pdffile/0009/2398185/plantations-australia-2020-vision.pdf (accessed 12 January 2015).

31 Department of Agriculture, *Submission 135*, p. 3.

32 Mr Alan Cummine has experience as a senior policy adviser to, and representative of, the forestry industry, *Submission 146*, p. 11.

33 Willmott Forests Limited, in the matter of Willmott Forests Limited (recs & mgrs apptd) (in liq) [2011] FCA 1517 (29 June 2011) [26]–[27].

34 Willmott Growers Group Inc v Willmott Forests Limited (recs & mgrs apptd) (in liq) [2013] HCA 51 (4 December 2013) [10].

35 The Australian Restructuring Insolvency & Turnaround Association (ARITA) gave the example of Willmott Forests Limited (WFL), which leased to growers portions of land which WFL owned or leased. The leases were made at various times. *Submission 23*, p. 2.

> There is no annual source of income and in the most simple forestry investments, the trees are established in the first year of the project and income is received when the trees are harvested a minimum of ten years later.[36]

2.26 Also, a single forestry scheme could be conducted on multiple plantations, which were distant from each other. Again using Willmott as an example:

> The growers' individual woodlots may be adjacent to woodlots in other schemes, and land used in the schemes is intermingled, creating a 'chequerboard' effect.
>
> The lots are divided and allocated to growers at random and land in various schemes is intermingled. This is true of all regions. To access its lot, an individual grower may have to cross other growers' land and to identify a grower's land, GPS is necessary, but not always possible. Surveying would be prohibitively expensive.[37]

2.27 The Great Southern Plantation 2003 Project was another such scheme. Members of the group (growers) participated in a scheme to grow and harvest timber in forestry plantations. Under the schemes, a grower would acquire an interest in a woodlot where trees would be grown and harvested on the grower's behalf.[38] The grower would enter into a land management agreement with GSMAL.

Fee structure

2.28 The fee structures for forestry projects generally require an up-front fee from investors, and deferred rental and management fee out of proceeds of the harvest, which can be many years later. Some forestry MIS, however, may require growers to make annual lease and management payments as well as the up-front fee.[39]

2.29 ASIC observed that fee structures that rely on up-front payments and payments out of proceeds from harvests have presented issues for the sector. This

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36 National Association of Forest Industries, A joint submission from the National Association of Forest Industries and Tree Plantations Australia to the Review of the Taxation of Plantation Forestry, p. 3, http://archive.treasury.gov.au/documents/1000/PDF/051_National_Association_of_Forest_Industries.pdf (accessed 3 January 2016).

37 Willmott Forests Limited, in the matter of Willmott Forests Limited (recs & mgrs apptd) (in liq) [2011] FCA 1517 (29 June 2011), [26]–[27]. Mr Crosbie described this arrangement.

38 Re Great Southern Finance Pty Ltd (in liq) [2013] VSC 351 (15 July 2013).

39 ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 74 and Regulatory Guide 232, *Agribusiness managed investment schemes: Improving disclosure for retail investors*, January 2012, paragraph 232.33 and *Submission 34*, paragraph 47 to this current inquiry.

structure requires the RE (or its ultimate parent) to absorb a sustained period of negative cashflows until the project produces enough income to meet its costs.[40]

Horticultural MIS

2.30 Horticultural MIS were also operating before the MIS regime commenced in 1998 but increased significantly after 2004. According to ASIC, the growth was due largely to Timbercorp's expansion into this sector. Non-forestry agribusiness MIS have focused on horticultural crops involving olives (for oil), almonds and wine grapes. Other horticultural crops include; macadamia nuts, citrus fruit, stone fruit, tomatoes, olives, table grapes, mangoes, avocados, truffles and wheat.[41]

2.31 The wait for a return on investment in these projects differs between crops but is less than forestry MIS. ASIC explained:

> Horticultural schemes (almonds, wine grapes and olives) are marketed in Australia as being fully income producing after 5 years. They then generally [are] expected to have a revenue producing life of up to 22 years.[42]

2.32 Horticulture projects, however, are labour and capital intensive in comparison to forestry MIS.[43]

2.33 While each horticultural MIS was structured differently, it is possible to make generalisations on how they operated.[44] In the main, agreements in an MIS comprised a constitution, a management agreement, a head lease and sublease and a compliance plan.[45] Normally, the schemes were structured around a contract between the grower and RE.

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40 *Submission 34*, paragraph 48 and ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 75.

41 ASIC, *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into aspects of agribusiness managed investment schemes, July 2009, paragraph 61.

42 ASIC, *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into aspects of agribusiness managed investment schemes, July 2009, paragraph 66.

43 ASIC, *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into aspects of agribusiness managed investment schemes, July 2009, paragraph 65.

44 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 2, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

45 See *Non-forestry Managed Investment Schemes*, Issues Paper, 2008, paragraph 13, http://archive.treasury.gov.au/documents/1401/PDF/Non-Forestry_Managed_Investment_Schemes_Issues_Paper.pdf (accessed 4 December 2014).

- The MIS operator leases land and water rights from land owners which are often associated with the MIS operator. The land owner usually funds all land preparation and infrastructure necessary for the project and acquires all necessary water licences. Most MIS projects are either fully or partially developed by the landowning entity at the time MIS participants are accepted into the project.
- After leasing the land and water rights, the MIS operator then divides these into allotments or plots, which are then subleased to individual MIS participants to conduct agribusinesses.
- The MIS operator then enters into a management agreement to operate and manage the agribusinesses of MIS participants. As a rule, the management agreement will be the same for all the MIS participants—there is a master agreement to which a list of MIS participants is attached.
- MIS participants pay the MIS operator an up-front fee as well as annual rent and management fees in return for managing the MIS project—in other words the growers enter into a contract with the RE to cultivate, maintain and harvest their agribusiness enterprise on their behalf.[46]
- The MIS operator enters into an operations agreement with another entity, the MIS manager, who is usually also associated with the MIS operator. The MIS manager manages day-to-day operations, from preparing land to harvesting. The MIS manager usually conducts these activities through contracting third parties to undertake the work. Generally the contractor makes the major decisions on how the farming activities are conducted with the MIS manager overseeing.
- Once the crop is harvested, the MIS operator contracts one or more companies to pack, store, transport and market the product.[47]

2.34 The MIS operator receives the proceeds from the sale of the harvested product and once received, holds them on trust for the MIS participants. The MIS operator keeps a proportion as a harvesting/marketing fee and distributes the remainder to MIS participants in proportion to the funds contributed and number of interests held. All produce grown on the project is pooled and the amount that a MIS participant receives takes no account of the price received for the variety grown on their individual allotment or of the yield from their allotment.[48]

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46 See *Non-forestry Managed Investment Schemes,* Issues Paper, 2008, paragraphs 14–18 and ASIC, Regulatory Guide 232, *Agribusiness managed investment schemes: Improving disclosure for retail investors*, January 2012, paragraph 232.33.

47 See *Non-forestry Managed Investment Schemes,* Issues Paper, 2008, paragraphs 14–22.

48 See *Non-forestry Managed Investment Schemes,* Issues Paper, 2008, paragraphs 14–22.

Fee structure

2.35 Generally horticultural projects require an upfront fee from growers and either:

- on-going annual rental and management fees to the manager to carry on the business as per the prospectus; or
- rental and annual fees paid out of net proceeds from harvests (for typical horticultural MIS, returns are generated after 4–5 years).[49]

2.36 Most commonly the fee structure for agricultural and horticultural public investment ventures was based on leasing an identifiable area of land to an investor. In some prospectuses, ownership of an identifiable area of land was offered to the investor.[50]

Agribusiness MIS collapses

2.37 After the introduction of the MIA, the number of agribusiness MIS grew steadily until the high profile collapses in 2009 and subsequent years. During the lead-up to these failures, there was a notable surge in investment in agribusiness MIS. In the peak year of 2006–07, investors placed over $1.2 billion in MIS projects.[51] According to figures cited by the National Farmers' Federation, the MIS industry managed to raise $1.079 billion in the 2007/08 financial year. Non-forestry projects received 35 per cent ($378 million) of total MIS funds.[52]

2.38 Statistics indicate that contributions to non-forestry MIS grew rapidly from $160 million in 2003–04 to $256 million for 2004–05, $445 million in 2005–06 and

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49 ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraphs 65 and 74; Regulatory Guide 232, *Agribusiness managed investment schemes: Improving disclosure for retail investors*, January 2012, paragraph 232.33; and Tracy Bramwell and Peter Chudleigh, *The Impact of Tax Driven Financial Investment on New Industry Development*, RIRDC Publication No 00/14, RIRDC Project No AGT–3A, February 2000, p. 1, https://rirdc.infoservices.com.au/items/00-014 (accessed 5 December 2014).

50 Tracy Bramwell and Peter Chudleigh, *The Impact of Tax Driven Financial Investment on New Industry Development*, RIRDC Publication No 00/14, RIRDC Project No AGT–3A, February 2000, pp. 9–10, https://rirdc.infoservices.com.au/items/00-014 (accessed 5 December 2014).

51 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The Changing Landscape of Australia's Forestry Investment Sector', p. 1, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

52 Submission to the Review of Non-Forestry Managed Investment Schemes, p. 3, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014). The National Farmers' Federation quoted figures from the Australian Agribusiness Group.

$467 million in 2006–07.[53] With regard to forestry MIS, according to NewForests, the MIS sector established almost 1 million hectares (2.5 million acres) of timber plantation in Australia between 1998 and 2008.[54] Overall, ASIC informed the committee that since the introduction of the MIS regime in 1998 agribusiness schemes had raised approximately $8 billion.[55] The following table provides detail on the funds invested in agribusiness and shows the amounts invested during the peak years of 2006–2008 and the sudden decline thereafter.

Table 2.1: Estimates of amounts invested in Agribusiness MIS 2000–2012[56]

Year	Amount invested Agribusiness MIS ($)	Timber ($)	Other($)	Projects	Participants
2012	40m	40m	0	4	165
2011	51m	48.6m	2.4m	10	491
2010	103m	74m	29m	14	2,474
2009	250m	227m	23m	26	7,560
2008	1.079b	701m	378m	56	24,300
2007	1,139b	672m	467m	67	24,500
2006	1,141b	698m	442m	57	25,800
2005	1,024b	767m	257m	47	~16,200
2004	665m	500m	165m	42	~15,800
2003	345m	247m	98m	45	
2002	300m	189m	111m	68	
2001	~500m				
2000	~800m				

Source—Australian Agribusiness end of year reports for 2000 to 2010 income years, Data for 2011 and 2012 income years estimated from ATO data.

53 *Non-Forestry Managed Investment Schemes*, Issues Paper, 2008, Chart 1: Growth in initial contributions to non-forestry MIS, p. 2.

54 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The Changing Landscape of Australia's Forestry Investment Sector', p. 1, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

55 Mr Greg Tanzer, *Proof Committee Hansard*, 14 October 2015, p. 18.

56 ATO, answer to question taken on notice, 14 October 2015.

2.39 In 2008, the industry was highly concentrated with Timbercorp, Great Southern and Gunns the major scheme operators. In the five years leading up to 2009, ASIC estimated that 'approximately $5 billion had been invested in agribusiness schemes by over 75,000 investors'. Forestry schemes represented approximately $3.7 billion of the $5 billion.[57] ASIC produced the following breakdown of the funds raised by major schemes:

- Timbercorp, around $1 billion;
- Great Southern, $1.8 billion;
- FEA Plantations, $426 million;
- Rewards Projects Limited, $291 million;
- Willmott Forests, about $400 million; and
- Gunns Plantations, about $1.8 billion.[58]

2.40 Timbercorp was the first major agribusiness MIS to fail followed by Great Southern.[59] Based on ASIC's analysis, the majority of investors in both the Great Southern and Timbercorp schemes were retail investors.[60] Since then, there have been only a small number of forestry MIS offered to retail investors. In addition, as a result of the winding up and deregistration of a number of these schemes, there has been a reduction in the number of registered schemes.[61]

2.41 In this report, the committee refers mainly to four of the main agribusiness MIS—Timbercorp, Great Southern, Willmott Forests and Gunns.

Timbercorp

2.42 Mr Robert Hance and Mr David Muir established the Timbercorp Group in 1992. They incorporated Timbercorp Eucalypts Ltd, an unlisted public company, which became known as Timbercorp Ltd. At the same time, Timbercorp Finance Pty Ltd was incorporated as a subsidiary to provide finance to investor growers. The Timbercorp Group of companies carried on business promoting managed investment

57 Mr Greg Tanzer, *Proof Committee Hansard*, 14 October 2015, p. 18.

58 Mr Greg Tanzer, *Proof Committee Hansard*, 14 October 2015, p. 18.

59 Environinvest Limited, which was the RE of nine MIS in forestry plantation projects and raised approximately $70 million from 320 investors, failed in 2008 with receivers and managers appointed in September 2008 to the Environinvest Group. See ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 167.

60 ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 55. This submission provides more detailed statistics on investors in Great Southern and Timbercorp.

61 Mr Greg Tanzer, *Proof Committee Hansard*, 14 October 2015, p. 18 and also refer to Table 2.1.

schemes. Investors, known as growers, invested and participated in the growing of trees, almonds, olives and other horticultural products.[62]

2.43 On 4 April 2000, Timbercorp Securities Ltd (TSL) was incorporated and replaced Timbercorp as the operator of the existing schemes and became the RE of each new scheme. TSL held an AFS licence and became the RE for 34 registered forestry and horticultural MIS, including eucalypts, almonds, olives, citrus, avocadoes, mangoes and grapes. According to ASIC, the majority of TSL's agricultural assets were in forestry plantations in Albany, WA and the Green Triangle region spanning the Victorian and South Australian border. TSL's substantial horticultural operations (mainly almonds and olives) were located across the country.[63]

Financing arm

2.44 As mentioned above Timbercorp Finance Pty Ltd was a subsidiary of the parent company and provided finance to investor growers.

Liquidation

2.45 On 23 April 2009, TSL, its ASX-listed parent Timbercorp Limited (Timbercorp) and around 40 other associated entities appointed KordaMentha as voluntary administrators.[64] The creditors resolved to put each one of the group companies into voluntary liquidation. At a meeting on 29 June 2009, the creditors resolved to wind up the companies and the administrators became joint and several liquidators.

2.46 At the time of its collapse and liquidation, there were 33 registered MIS and three unregistered private scheme offers. TSL schemes had approximately 18,400 investors who had invested $1.095 billion.[65] As a result of the collapse, the majority of the Timbercorp schemes could not be carried to completion, meaning the investments were of limited or no value. Following the collapse, liquidators also commenced or

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62 Woodcroft-Brown v Timbercorp Securities Ltd (in liq), [2011] VCS 427 (1 September 2011) [1].

63 ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 172.

64 ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 169.

65 ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 169. See also Simon A. de Garis, *Rural Managed Investment Schemes in Victoria, Australia: The demise of Timbercorp*, Paper presented at the Pacific Rim Real Estate Society Conference, Wellington, New Zealand, January 2010. Mr de Garis was Senior Lecturer, School of Property Construction and Project Management, RMIT University Melbourne, http://www.prres.net/papers/Degaris_Rural_Managed_Investment_Schemes_Victoria_Australia-Demise_Timbercorp.pdf (accessed 5 December 2014).

threatened recovery actions against investors who had borrowed money from Timbercorp Finance. Timbercorp Finance had outstanding loans to over 14,500 investors, totalling $477.8 million.[66]

Great Southern

2.47 The Great Southern group of companies grew to become the largest manager of agricultural-based MIS in Australia and the largest owner of land for commercially grown hardwood plantations.[67] Great Southern Managers Australia Limited (GSMAL) was an Australian Financial Services (AFS) licensee and RE of 43 registered forestry and horticultural MIS and raised around $2 billion between and 2004 and 2009 from 43,000 investors.[68] According to ASIC, the majority of GSMAL's agricultural assets were in forestry plantations located in Western Australia and the Green Triangle region. GSMAL also conducted substantial horticultural operations (olives, wine grapes and almonds) which were spread across the country.[69]

Financing arm

2.48 Many investors in Great Southern took advantage of finance offered by Great Southern Finance, which was facilitated through Great Southern's arrangements with Bendigo and Adelaide Bank.[70] Great Southern Finance Pty Ltd (GSF) was the financing arm of the Great Southern Group.[71]

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66 Woodcroft-Brown v Timbercorp Securities Ltd (in liq), [2011] VCS 427 (1 September 2011) [2].

67 Bendigo and Adelaide Bank, response to *Submissions 52* et al, dated 24 December 2014, p. [1].

68 Deed of Settlement proposed by Liquidators. ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 173. The number of schemes was recorded as 'approximately 44' in Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [69] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq), [2014] VSC 516.

69 ASIC, *Submission* 58 to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraph 177.

70 See Mr Michael Galvin, who was one of a team of lawyers who represented plaintiffs in 16 class actions in the Supreme Court of Victoria arising out of the collapse in 2009 of the Great Southern group, *Proof Committee Hansard*, 6 August 2015, p. 30.

71 Clarke v Great Southern Finance Pty Ltd (recs & mgrs apptd) [2012] VSC 260 (20 June 2012), [3]–[5].

Liquidation

2.49 The Great Southern Group collapsed in May 2009 and joint and several voluntary administrators were appointed.[72] At that time, the Great Southern Group comprised the parent company, GSL, and 34 subsidiaries.[73] On 19 November 2009, creditors resolved to appoint the liquidators as joint and several liquidators of GSMAL. GSMAL and GSF were wholly owned subsidiaries of GSL.[74]

2.50 The Bendigo and Adelaide Bank made it clear that at the time administrators, receivers and liquidators were appointed to the Great Southern group of companies, no administrators were appointed to the Great Southern plantation schemes. It explained:

> Following a competitive process largely financed on behalf of investors by Bendigo and Adelaide Bank…Gunns Plantations Ltd was appointed to replace GSMAL as responsible entity for most of the Great Southern plantation schemes in December 2009 and January 2010. Gunns, and other bidders for the role, intended to manage the schemes through to completion on behalf of investors. [75]

2.51 Unfortunately for investors in Great Southern MIS, Gunns also struggled to make the schemes profitable and ultimately administrators were appointed in September 2012. Put simply, the plantation managed investment schemes did not have the resources to manage the plantations to completion.[76]

Willmott Forests Limited (WFL)

2.52 Willmott Forests Limited (WFL), which was the RE for a number of managed investment schemes, collapsed financially in September 2010 and receivers and voluntary administrators were appointed.

2.53 On 26 October 2010, new voluntary administrators were appointed. They determined that WFL was 'insolvent and without funds to meet its debts, comply with its statutory obligations as owner/manager of the plantations and fulfil its obligations to the growers and third parties under the constituent documents'.[77] Subsequently, in

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72 ASIC, *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into agribusiness managed investment schemes, July 2009, paragraphs 174–176. Also see Clarke v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq), [2014] VSC 516, [75].

73 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [67] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq), [2014] VSC 516.

74 See Deed of Settlement proposed by Liquidators, May 2014, p. 4.

75 Bendigo and Adelaide Bank, response to *Submissions 52* et al, dated 24 December 2014, p. [5].

76 Bendigo and Adelaide Bank, response to *Submissions 52* et al, dated 24 December 2014, p. [5].

77 Willmott Forests Limited, in the matter of Willmott Forests Limited (recs & mgrs apptd) (in liq) [2011] FCA 1517 (29 June 2011) [35].

March 2011, the creditors of WFL resolved that the company be wound up and liquidators appointed. The liquidators found that the Willmott schemes could not continue to operate and that it was 'very unlikely' that 'a party would be willing to take over as RE and manager of the schemes'. They set in train a process to sell the assets.[78]

Gunns

2.54 Gunns Plantations Limited (GPL) was formed in 1999 and, as noted above, also acted as the RE for the Great Southern Pulpwood Forestry Schemes (1998–2006).[79]

2.55 In September 2012, an ANZ-led syndicate of banks that were owed about $560 million appointed KordaMentha as receivers. They were to carry out a detailed analysis of plantation timber managed-investment schemes run by the company, 'into which thousands of investors had pumped about $600 million'.[80] PPB Advisory, specialists in corporate recovery, restructure and insolvency, were appointed as administrators of GPL on 25 September 2012 and liquidators on 5 March 2013.

2.56 Following, the collapse of the Gunns Group, the liquidators sought expressions of interest for a RE, but, according to the court:

> With the exception of the 2000 and 2001 schemes, no satisfactory replacement could be found. GPL had no funds. The scheme landowners were in receivership. The receivers had issued notices of default to GPL under Forestry Right Deeds, adding further uncertainty to the growers' position and their ability to recover any value from their investments.[81]

2.57 Without a properly funded entity to assume all the responsibilities and obligations of an RE for the schemes, the court was satisfied that 'the only course open to the liquidators was to sell the schemes'.[82]

Conclusion

2.58 Although the MIA was intended to strengthen investor protection, the collapse of a number of high-profile agribusiness MIS has resulted in substantial financial losses for investors in such schemes. Before looking more closely at the failure and

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78 Willmott Growers Group Inc v Willmott Forests Limited (recs & mgrs apptd) (in liq) [2013] HCA 51 (4 December 2013) [15].

79 Gunns Limited, home page 'Our Business', http://gunns.com.au/our-business/ (accessed 22 September 2015).

80 ASX, http://www.delisted.com.au/company/gunns-limited (accessed 22 September 2015).

81 Re Gunns Plantations Limited (in liq) (recs & mgrs apptd) (No 4) [2014] VSC 369 (11 August 2014) [11].

82 Re Gunns Plantations Limited (in liq)(recs & mgrs apptd) (No 4) [2014] VSC 369 (11 August 2014) [11].

liquidation of agribusiness MIS, the committee seeks to highlight the human dimension of the failure of these schemes and to bring to the fore the lived experiences of the investors.

Part I—Retail investors and incentives to invest

The collapse of a number of high-profile agribusiness MIS has resulted in substantial financial losses for investors in such schemes. In this part of the report, the committee provides some insight into the emotional, physical and financial harm caused by the failure of these schemes and the reasons retail investors, with little or no experience in investments, entered into these ventures.

The committee considers the use of tax incentives as a driver to invest in agribusiness MIS and how the concessions were used as a selling point. It looks at the motivations that encouraged investors to take out recourse loans to fund their investment; their understanding, or as it turned out their misunderstanding, of the loan arrangements; the trust they placed in their advisors; and finally their vulnerability and high susceptibility to the marketing techniques used to promote and sell agribusiness MIS.

Chapter 3

Human cost

> The reason I need to bring my story for your attention and consideration is based on the current suffering and personal circumstances that have forced us to sell our family home that we have lived in and made home for the last 14 years. This is just a small part of the impact that this Timbercorp story has had on me and my family. I myself now suffer from depression. As well as being a type 1 diabetic, I now have to take more medication daily to treat my depression which is now constantly affecting my life and the life of my family. This goes hand in hand with the stress that has been put on my marriage and my family life on a daily basis since Timbercorp collapsed.[1]

3.1 People from all walks of life and of varying ages were encouraged to become investors and, moreover, to borrow to invest in agribusiness MIS. As a group, many investors, known as growers, bore the brunt of the massive losses occasioned by the MIS failures.[2] Importantly, they could not be characterised as sophisticated investors but as retail investors entering into complex borrowing arrangements to finance a speculative venture.

3.2 For the purposes of this inquiry, the committee is concerned primarily with retail investors, many of whom were first time investors and not highly literate in financial matters.[3] When the schemes collapsed, many of these investors lost not only their investment and prospects of future income but were saddled with the burden of repaying the loans and interest on a valueless asset. In this chapter, the committee looks at the personal toll on growers who lost out on their investment in agribusiness MIS.

Personal accounts

3.3 Evidence before the committee is replete with stories of the shattered lives of people who invested and borrowed to invest in agribusiness MIS—separation, broken relationships, lost life savings, bankruptcy, damaged health, depression, self-harm and

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1 Name withheld, *Submission 72.*

2 See Clarendon Lawyers, Submission to CAMAC, Managed Investment Schemes, paragraphs 3.2.2 and 3.2.3.

3 For the purposes of this inquiry, the committee does not discuss the propriety of the legal definition of a retail investor as determined in regulations 7.1.18–7.1.28. The committee however, uses this test as a guide: that is the value of the financial product should be under $500,000 and net assets of under $2.5 million or gross income for each of the last two financial years under $250,000. Applying this test, the great majority of growers who wrote to the committee would be categorised as retail investors: they were inexperienced investors with limited knowledge of financial products and ill-equipped to appreciate the risks involved in more complex financial products.

families placed under enormous stress.[4] For example, with the likelihood of bankruptcy hanging over his head, one investor, a director of a small business, feared for his position and the possible termination of the business. Another grower stated simply that the failed scheme had left his 'financial position and superannuation in tatters'.[5]

3.4 Other investors found the prospect of rebuilding their lives unattainable: a number were forced to live in temporary mobile accommodation while some had contemplated suicide. An investor, who described herself as 'an everyday suburban mother, was 'paralysed, angry, confused and perplexed at the whole saga'.[6] Without doubt, the failure of these various MIS has taken a heavy toll, emotionally, physically and financially, on investors. One such investor stated:

> We had to sell our family home in 2013 to try and reduce our debt and we now live in a shed on a block of land out of the Perth metro areas as we could not afford to buy another family home.[7]

3.5 Since the global financial crisis (GFC) and because of their failed investment in Great Southern, a 63-year old man and his wife have been living in a 16-foot caravan having lost their home, superannuation, savings, life insurance and 'somewhere for the grandchildren to stay with them'. They are unable to find full employment because they do not have a fixed address and, in their words, face 'an extremely bleak future'.[8] Another described the devastation to her family's emotional, financial and physical wellbeing:

> We nearly found ourselves divorced and in counselling through all this mess, my health has taken a turn for the worse. I am living with an Auto Immune disease and depression, brought on by increased stress...The decision to put a stop to growing our family has been made because of the financial uncertainty that we face...I have to work and cannot be the stay at home mum I would like to be...My only child may very well just be an only child, this saddens me and has caused many arguments in our house.[9]

3.6 A couple described their grim situation, which:

> …has robbed us of any plans we once had for the future and will strip us bare of almost everything we have ever worked for. Now aged in our late

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4 See, for example, *Submissions 1*, *2*, 6, *28*, *31*, *33*, *55*, *57*, *61*, *62*, *72*, *73*, *75*, *76*, *77*, *78*, *93*, *101*, *112*, *113*, *114*, *115*, *117*, *123*, *131*, *147*, *162*, *167* and *169*. See also Ms Naomi Halpern and Mr Bernard Kelly, *Proof Committee Hansard*, 12 November 2014, pp. 2, 4. *Confidential Submissions 8*, *35*, *37*, *59*, *66*, *83*, *116*, *131*, *192*.

5 Mr Brad Pearce, *Submission 111*, p. 1.

6 *Confidential Submission 92*, p. [2].

7 Name withheld, *Submission 33*, p. [1].

8 Mr Alexander McShane, *Proof Committee Hansard*, 6 August 2015, p. 3.

9 Name withheld, *Submission 75*, p. [1].

> 50s, we live in fear of never being able to recover from this mismanaged debacle.[10]

3.7 Another couple indicated:

> The last five years of uncertainty has had a devastating effect on our lives. The damage on our marriage, our heath and overall state is irreparable. We feel helpless in doing the most basic thing of providing for our children. The ability to retire seems far gone as we face the very real prospect of losing our home. It is hard to imagine our financial future, as it stands; there is none.[11]

3.8 Many were on the brink of selling, or had sold, their family home to meet their loan obligations.[12] The father of three young boys, forced to relinquish his home at a loss, stated:

> We understand that investments don't always work out, but this is an extreme outcome. We were trying to make our future financially better and through no fault of our own our financial future is dire. We need a commercial outcome that is fair and achievable and not a hopeless situation.[13]

3.9 In his words, '[w]e cannot afford to pay back 85c in the dollar and feel very strongly it is unfair to have to do that. We have done nothing wrong, nothing illegal and yet we are made to feel that way by the aggressive tactics of the liquidators'.[14] Many others found themselves in a similar situation. According to another grower:

> I'm 42 years old with three dependent children and this was going to be my long term investment for retirement.[15]

3.10 Mr Peter Jack described the considerable strain that his family was experiencing because of the failure of Timbercorp:

> We have gone from having a secure future to now a future of uncertainty with the very real and present danger of our livelihood being destroyed and the forced sale of our family home.[16]

3.11 A number of investors lost, or put at risk, their superannuation. One such investor stated:

10 *Confidential Submission 37*, p. 1.

11 Name withheld, *Submission 102*, p. [1].

12 Name withheld, *Submission 31*, p. 1.

13 Name withheld, *Submission 18*, p. 1.

14 Name withheld, *Submission 18*, p. 1.

15 Name withheld, *Submission 62*, p. 1.

16 *Submission 25*, p. 1.

> The only way I could pay this loan would be to [take] money from my superannuation fund to repay which will further affect my finances for the rest of my life.[17]

3.12 Mr Peter Tomasetti stated simply 'Our superannuation savings were lost'.[18]

3.13 A number of the growers invested in the schemes at a time of their lives when recovering from a financial loss would be difficult if not impossible. One grower aged 53 suggested that he was nearly unemployable and will have no choice but to declare bankruptcy and 'go on the dole and possibly be forced into government housing'.[19] Another told the committee that at his age he will never own a home again or regain the same financial security he once had.[20] Yet another couple around the same age could only hint at their predicament:

> At the age of 54, we are now on the brink of being financially wiped out/bankrupted/back to square one in getting somewhere with a roof over our heads, when we should be getting ready for the next enjoyable phase of life.[21]

3.14 One older couple stated:

> We are retirees aged 71 and 68 who have lost our life savings, superannuation and will now have to sell our home to repay loans to a bank for investments in Great Southern MIS schemes which we should never have been given.[22]

3.15 A single older female informed the committee that, in April 2008, she went to a financial adviser (based on a recommendation from a friend) to set herself up for retirement. She explained that she wanted to 'be self-sustaining and not reliant on the government pension'. Her biggest fear was being unable to take care of and feed herself. She explained:

> If I am forced to repay this money I will LOSE my home, I will have nothing for my future. I think the emotional impact of this is untenable, I hope I am more tenacious than this but there is a part of me that would prefer to 'just give up' if this is to be the outcome.[23]

3.16 One submitter summed up the desperation facing those who borrowed to finance their investment in agribusiness MIS and who continue to see their debt mount:

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17 Name withheld, *Submission 30*, p. 1.

18 *Submission 170*, paragraph 27.

19 *Confidential Submission 40*.

20 *Confidential Submission 35*.

21 Name withheld, *Submission 61*, p. 1.

22 Name withheld, *Submission 65*, p. 1.

23 Name withheld, *Submission 73*, p. 1 (emphasis in original).

> This situation requires rapid restitution to stop this type of under-handed thievery once and for all. We bear witness to the accumulating, depressive, detrimental effect of MIS collusion as we watch our lives slip by, year after year, without a fair resolution. Why should a daily walk to the letterbox cause our heart to pound with anxiety? Not to mention the sudden panic that erupts at the sight of a courier van in our street…when all we can do is close our eyes and pray that the driver continues on his way without stopping to knock on our door to serve the writ that will ultimately seal our fate. How much longer do we have to hold our breath in fear, and then exhale feeling totally drained of the energy we need to face yet another day of this relentless pressure?[24]

3.17 The stories retold here do not adequately convey the deep pain and suffering endured by many of the growers who invested in MIS. Some struggled to put together their submission because re-living it was 'extremely confronting', while others could not summons the energy and have remained silent.[25]

3.18 In the following chapters, the committee examines the factors that enticed people to invest in agribusiness MIS.

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24 *Confidential Submission 37,* p. 3.

25 See, for example, Mr Bernard Kelly, *Submission 117,* p. [1].

Chapter 4

Taxation concessions

> I was one of the group of people that believed that if an investment had a PDS then that was a stamp of approval by ASIC. As it had a tax ruling, I believed that was a stamp of approval by the ATO.[1]

4.1 Since their beginnings, MIS have attracted taxation benefits. For tax purposes, investors in an agribusiness MIS are recognised as 'carrying on a business' whereby they are able to claim tax deductions for costs associated with the normal operations of their business. Researchers Tracy Bramwell and Peter Chudleigh described tax-driven agricultural and horticultural development schemes as:

> …those that rely on raising large amounts of financial resources with significant tax effectiveness from many investors and where these resources are used for development of agricultural/ horticultural enterprises.[2]

4.2 In this chapter, the committee is not concerned with the merits, or otherwise, of the tax concessions allowed to investors in agribusiness MIS. The committee is primarily interested in how these schemes were promoted as tax effective schemes; the extent to which the tax incentive was an effective and appropriate enticement to invest; and investors understanding of what the tax benefit meant for their investment.

Tax benefits as driver of investment

4.3 Much has been written about the tax incentives offered to investors in agribusiness schemes, including commentary generated during the committee's inquiry into mass marketed tax effective schemes in 2001–2002.

4.4 Unlike previous inquiries, the committee's current inquiry attracted many submissions from investors who explained the role of the tax incentives in their decision to invest. Their evidence shows that the broad assertion about the tax benefits determining the decision to invest was too simplistic. Of the investors who made submissions to the inquiry, many indicated that the tax benefit was only part of their

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1 Name withheld, *Submission 151*, p. 5.

2 Tracy Bramwell and Peter Chudleigh, *The Impact of Tax Driven Financial Investment on New Industry Development*, RIRDC Publication No 00/14, RIRDC Project No AGT–3A, February 2000, p. iii, https://rirdc.infoservices.com.au/items/00-014 (accessed 5 December 2014).

reason for investing in an agribusiness MIS and definitely not the driving force.[3] Indeed, some provided information on their annual income, which could only be described as modest.

4.5 Clearly, a number of the investors were not high wealth individuals. For example, one couple noted:

> Per our tax returns, we had jointly earned $82,000 in 2005 and $95,000 in 2006. Steve's [the adviser] recommendation was that we invest $126,000 in the 2007 scheme between us, all funded via Great Southern Finance.[4]

4.6 Another stated simply that there was no benefit for her to invest in Timbercorp because she was not in a high tax bracket.[5] A third example came from a man on $75,000 a year with immediate plans for his wife to stop working to look after family.[6]

4.7 In general, the growers were not astute investors knowledgeable about minimising their tax. Rather, for many of the investors who wrote to the committee, the assumption that the investment would provide a secure and stable return was paramount.[7] They wanted to 'find a low-risk way to make long-term investments' that would secure their future.[8] For example, one grower stated:

> At the time in 2008 I was a single mother working over 40 hours a week, studying at night school whilst raising teenage children. I was paying more than required into my mortgage and thought that if I was able to take this money and invest it for long term gain my life would not always be so hard. This was a massive step for me; I am a hard worker and did not have money to spare but was advised by the Financial Advisor this Timbercorp investment in 2008 would be of great benefit for me to become part of the forest industry growth.[9]

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3 See Mr Neil White, Melbourne-based financial planner and Chairman of the Agriculture Growers Action Group, informed the committee that 'Despite common public perceptions, members of the group were 'not high-net-worth individuals', *Proof Committee Hansard*, 12 November 2014, p. 32. See also, Mr Michael Galvin, *Proof Committee Hansard*, 6 August 2015, p. 31; name withheld, *Submission 120*, p. [1]; *Confidential Submission 36*; and *Confidential Submission 141*, p. [1].

4 Name withheld, *Submission 56*, p. [2].

5 *Confidential Submission 38*, p. 1.

6 Name withheld, *Submission 153*, pp. 3–4 and, as another example, Mr Tyson O'Shannassy *Submission 158*, p. 4.

7 Name withheld, *Submission 48*, p. 1; *Submission 109*, p. 2; *Submission 120*, p. [1]; name withheld, *Submission 167*, p. [1]; Mr Neil White, *Proof Committee Hansard*, 12 November 2014, p. 32; and *Confidential Submission 140*.

8 *Confidential Submission 154*, p. [1].

9 Name withheld, *Submission 30*, p. 1.

4.8 One couple informed the committee that they were advised that investing in the scheme was 'a good option' for them, as they were 'investing in the agricultural business and it was a long term investment that would provide dividends'.[10] The promise of future returns attracted some parents who hoped to use the income to fund a good education for their young children.[11] For example, one such grower stated categorically that his investment was not 'a tax dodge'. He was looking to provide his daughters with a start in life—education, car and marriage.[12]

4.9 Mr Peter Jack informed the committee that his goal was also to use the scheme to provide for his family and was looking to secure a funding source to help meet the cost of educating his four children.[13] The same motive encouraged yet another couple to invest in MIS. They were led to believe that the project was long term, safe in nature, approved by the ATO, and a great investment for the future. They informed the committee:

> Our reasoning for investing in the project was to provide for our young family and have a better financial future.[14]

4.10 Another grower explained that, while there were some tax advantages to MIS investing, the reason he invested in Timbercorp was to try to secure a bright future for his family but 'all that is left is dark clouds'.[15] Others envisaged the investment as a long term venture and a means of boosting future superannuation.[16] For example, Ms Barbara Gray stated:

> We would not consider ourselves naïve investors however require a good return on any funds invested for not only future retirement but a healthy age related annuity profile when that became available.
>
> Timbercorp, FEA Plantations and two Macquarie Bank managed funds were presumably investigated and then recommended to us as legitimate tax alternatives. And we went ahead with those investments on our Accountants recommendation.[17]

4.11 Peter and Elaine Wilson, who planned to be self-funded retirees, rejected the notion put forward by the courts that they only invested as a tax evasion. They informed the committee that they invested to have an income stream in their retirement.[18] Similarly, Mr Brett Lawtie informed the committee that his adviser told

10 Name withheld, *Submission 97*, p. [1].

11 Name withheld, *Submission 120*, p. [1].

12 Mr Ken Grech, *Submission 123*, p. 1.

13 *Submission 25*, p. 1.

14 Name withheld, *Submission 72*, p. 1.

15 Name withheld, *Submission 31*, p. [2].

16 Name withheld, *Submission 42*, p. [4].

17 *Submission 54*, p. [1].

18 *Submission 49*, p. 1.

him that he needed to invest in some agribusiness to aid in retirement planning and signed up for $35,000 worth of almonds and olives. Mr Lawtie contended that his intention was 'purely for retirement planning NOT tax avoidance'.[19]

4.12 Another couple, a bus driver and his wife, a part time retail assistant, were not, according to their own assessment, 'the investing type'. They indicated that they did not need to reduce their tax, and 'certainly did not go into this with the view that this was a tax minimisation scheme'.[20] Likewise, another couple told the committee that they invested in Timbercorp after their financial planner explained and recommended not only the tax deductions but also the promise of a 23 year-long income. They explained:

> At the time [the Husband] had been retrenched after 14 years and as we were entering our 50s with young children we were encouraged to prepare long term for our golden years. The project was partly financed by us (10% initial deposit) and internally financed by Timbercorp Finance (90% lent).[21]

4.13 Some submitters were also persuaded to invest on the understanding that the schemes would be helping people in rural districts—farmers, farm hands and local tradespeople.[22] One such investor stated:

> Based on the financial advice and reasons why it would be a good investments in that we were supporting Australian farmers and hence contributing to the Australian economy.[23]

4.14 A similar incentive prompted another grower to invest in an agribusiness MIS—not only to accumulate funds for retirement and to generate passive cash flows for future financial security but to help contribute to the growth of rural Australia.[24] Mr Peter Crean informed the committee that he was advised to invest in ITC pulpwood and sandalwood projects as he would be turning 65 at the time. He explained that he and his wife:

> …felt good about the investment as the return promised to be good and also we were investing in Primary production which we thought was good for Australia.[25]

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19 *Submission 1*, p. 1 (emphasis in original). Mr Lawtie's adviser was Mr David Radovan, formally of Infocus, who was found guilty by ASIC and banned for 5 years. ASIC, 10-217AD 'ASIC bans WA financial adviser', 26 October 2010, http://asic.gov.au/about-asic/media-centre/find-a-media-release/2010-releases/10-217ad-asic-bans-wa-financial-adviser/ (accessed 22 September 2015).

20 Name withheld, *Submission 95*, p. [1].

21 Name withheld, *Submission 102*, p. 1.

22 Name withheld, *Submission 42*, p. [4].

23 Name withheld, *Submission* 33, p. [1].

24 Mr Stefan Kaiser, *Submission 107*, p. 5.

25 *Submission 19*, p. 1.

4.15 Similarly, Mr Trevor Burdon, a grower investor and environmentalist, 'invested to provide the forestry industry with alternative resource to heritage forest stocks in the Snowy Mountains and Tasmania, to promote local industry (especially in Tasmania), and to generate a return to support my independent retirement'.[26]

Committee view

4.16 Certainly not all growers were simply looking for a way to minimise their tax: their modest incomes confirming that such an intention was not a significant consideration. In many cases, the clear and consistent evidence attests to the fact that the tax aspect was not the primary incentive.

4.17 While the tax advantage may not have been the highest priority for some investors, it was a factor and certainly a major plank in the marketing strategy for these products. But even investors primarily motivated by the tax advantages were entitled to sound advice appropriately tailored to their particular circumstances. For such growers, their claims for tax benefits were generally legal. As the Australian National Audit Office (ANAO) noted in 2004:

> Taxpayers have the right to arrange their financial affairs to minimise tax, but it is not acceptable to do so by avoiding the intent of the law or by not following the law itself.[27]

4.18 As noted earlier, agribusiness MIS usually take some time before they earn any income (5 to 20 years). If the investor receives all the tax deductions up front, any income earned later is taxable. It should also be noted that the ATO may query the tax deductibility of the loan interest if the investor 'appears not to be taking any real "business risk"'.[28] There were no suggestions that growers were avoiding their tax obligations but, as noted above, even investors seeking the tax advantage should not have been encouraged to invest in high risk, highly geared products if they were retail investors. They certainly should not have been led to assume that ATO rulings were an endorsement of the scheme.

Significance of ATO rulings

4.19 Australia's self-assessment taxation system relies on taxpayers having a reasonable understanding of taxation law so they are able to fulfil their tax obligations. Thus, an important element of the ATO's administration of the taxation law is the provision of interpretative advice on taxation issues. Under this self-assessment

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26 *Submission 187*, paragraph 11.

27 ANAO, Audit Report No.23 2003–04, Performance Audit, *The Australian Taxation Office's Management of Aggressive Tax Planning*, Australian Taxation Office, 2004, paragraph 8, http://www.anao.gov.au/~/media/Uploads/Documents/2003%2004_audit_report_23.pdf (accessed 12 January 2014).

28 ASIC, answer to question on notice, No. 3, 2 October 2015.

regime, the Commissioner of Taxation may issue both public and private rulings that are legally binding on the Commissioner.[29]

4.20 In June 1998, in an attempt to preserve the integrity of the tax system, the ATO introduced product rulings. These rulings allowed promoters of MIS to provide relevant information to the ATO, which could then rule on the deductibility of scheme payments for participants in the scheme. Such rulings gave investors certainty about the deductibility status of their claim but only on condition that the scheme was implemented according to the information on which the ATO ruled.

Early problems around tax rulings

4.21 During the early 2000s, a significant number of investors in agribusiness MIS were caught out by having the ATO deem their tax deduction ineligible. At that time, the ATO announced it would initiate aggressive tax measures, which would include issuing amended assessments to approximately 40,000 taxpayers who had invested in MIS.[30] The assessments effectively disallowed some deductions and required investors to repay the deducted amount plus penalties and interest. Because the deductions covered a number of years, some investors faced paying substantial amounts of money.[31]

4.22 In response to the criticism of the ATO's action in requiring investors to repay their deductions and hefty penalties, this committee inquired into the mass marketing of tax effective schemes. In June 2001, the committee tabled an interim report that considered the economic, social and personal effect of the then ATO recovery action on taxpayers involved in these tax effective schemes. At that stage of the inquiry, the committee was primarily concerned with whether the level of the tax burden imposed on scheme participants, caught up in what was held to be tax avoidance arrangements, was justified.[32] Notably, the harm caused to investors was not the collapse of the schemes but the improper marketing of schemes that promoted tax benefits and the

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29 Inspector-General of Taxation, Appendix 3: *History of Australia's system for public advice on income taxation matters*, a report to the Assistant Treasurer, 7 April 2009, http://igt.gov.au/publications/reports-of-reviews/administration-of-public-binding-advice/appendix-3-history-of-australias-system-for-public-advice-on-income-taxation-matters/ (accessed 4 January 2016).

30 See, for example, Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging* industries, No 05/078, RIRDC Project No AWT–1A, January 2006, p. 4, https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

31 See, for example, Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging* industries, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, pp. 4. https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

32 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Interim report, June 2001, p. 1.

ATO's decision to deny such claims.[33] Of relevance to this current inquiry, however, is the potential for ATO's rulings to be misrepresented or misused. For example, with regard to an ATO private binding ruling (PBR), the committee observed in 2001 that:

> Although only a small number of PBRs were issued, it appears that promoters and designers exploited them to market schemes *en masse*. Common practice included using a PBR to market later versions of a scheme or schemes with comparable features. While promoters misused PBRs in this fashion, it seems that many scheme participants relied upon them as a seal of ATO approval or saw them as representing the ATO line on schemes in general.[34]

4.23 The committee's finding in 2001 that financial advisers did not appear to have advised their clients fully of the risks involved in investing in these schemes, particularly the risk of the ATO taking a different view of the arrangements is also of relevance to this current inquiry.[35]

4.24 In its 2001 report, the committee highlighted the problem of investors misconstruing the ATO's rulings on mass marketed tax effective schemes and interpreting them as an endorsement of the product. At that time, ASIC conceded that the schemes were generally sold on their tax advantages and that on occasion, they were mis-sold on those benefits. Clearly, in 2001 there were warning signs about the possible misuse of ATO rulings when it came to promoting and marketing agribusiness MIS.

4.25 Five years on, a study found that the ATO's product rulings system had substantially resolved taxation uncertainty for MIS participants. According to the study, product rulings were in effect a move away from 'pure' self-assessment and a useful development. It warned, however, that, while providing clarity on the eligibility of tax deductions for investors in MIS, the ATO product rulings were not intended to

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33 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final report, February 2002, pp. 5–7.

34 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Interim report, June 2001, p. 23. A private ruling is binding advice that sets out how a tax law applies in relation to a specific scheme or circumstance and applies to the individual taxpayer who requested the ruling. In 2001, the committee formed the view that 'the influence on investor perceptions of PBRs used to market schemes needs to be recognised. Insofar as PBRs were used as marketing tools to encourage participants to believe they represented a general ATO position, participants were poorly served by both promoters and advisers, particularly tax practitioners who would have known that this was an improper use of PBRs and that no certainty existed for anyone except the PBR applicant'.

35 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final report, February 2002, p. 34.

indicate, and certainly not endorse, the commercial viability of the respective product.[36]

4.26 In its 2008 submission to the non-forestry MIS review, the National Farmers' Federation (NFF) raised concerns about the potential for the ATO product ruling processes to exert undue influence over investor decisions.[37]

Warnings—not sanctioning the commercial viability of product

4.27 As explained earlier, the Commissioner of Taxation may issue public rulings that are legally binding on the Commissioner.[38] An ATO public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applied, or would apply, 'to entities generally or to a class of entities in relation to a particular scheme or a class of schemes'.[39] The ATO may allow an investor to claim the operating expenses of an agribusiness MIS as a tax deduction against the investor's total income, which are allowed through a system of product rulings that describe the specific cost items deemed legitimate deductable expenses. Product rulings are binding public rulings about a product such as an investment arrangement or a tax effective arrangement.

4.28 The committee understands that while a product ruling from the ATO provides entities covered by that ruling with certainty as to the tax consequences of participating in that particular MIS, the product ruling provides no assurance that:

- the scheme is commercially viable;
- the fees, charges and other costs are reasonable or they represent industry norms; or

36 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries*, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, pp. 10–11 and 48.

37 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 4, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014).

38 Inspector-General of Taxation, Appendix 3: *History of Australia's system for public advice on income taxation matters*, a report to the Assistant Treasurer, 7 April 2009, http://igt.gov.au/publications/reports-of-reviews/administration-of-public-binding-advice/appendix-3-history-of-australias-system-for-public-advice-on-income-taxation-matters/ (accessed 4 January 2016).

39 ATO, Product Ruling, PR 2007/71, http://law.ato.gov.au/atolaw/view.htm?Docid=PRR/PR200771/NAT/ATO/00001 (accessed 15 December 2014). According to the ATO, the investor would be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by the ruling if it turned out that it did not correctly state how the relevant provision applied to the investor.

- the projected returns will be achieved or are reasonably based.[40]

4.29 In its product rulings, the ATO advises potential participating entities to 'form their own view about the commercial and financial viability of the scheme'.[41] It advises further that this assessment should involve considering important issues such as the 'track record' of the management; the level of fees in comparison to similar products; how the product fits an existing portfolio; and whether projected returns are realistic.

4.30 ASIC also drew attention to the fact that the ATO makes 'an express representation in every product ruling it issues that it does not sanction nor guarantee any product as an investment'.[42]

4.31 While the ATO makes clear in its product rulings that it does not sanction or provide assurances as to the commercial viability of the product subject to the ruling, evidence indicates that some investors missed this message. In this regard, ASIC acknowledged that investors may fail to have regard to warnings issued about these products.[43]

Product ruling—perceived endorsement

4.32 There can be no question that a number of product producers and financial advisers used the ATO ruling as a marketing ploy that succeeded in convincing some investors that the ATO had in fact 'approved' the scheme. For example, Mr David Cornish, a private consultant who focuses on agricultural investment, informed the committee of his concern that investors did not fully appreciate the standing of product rulings. He also accepted that when issuing a ruling on a scheme, the ATO did not, in any way, make a judgment on the financial viability or reasonableness of that scheme. In his opinion, however, it would seem that the general public derived a level of comfort from an ATO product ruling that a scheme would be viable.[44]

4.33 Mr John Lawrence, an economist, tax accountant and more recently a public policy researcher, similarly noted how people were fundamentally mistaken in

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40 ATO, Product Ruling, PR 2007/71, http://law.ato.gov.au/atolaw/view.htm?Docid=PRR/PR200771/NAT/ATO/00001 (accessed 15 December 2014). See also PR 2004/116.

41 ATO, Product Ruling, PR 2007/71, http://law.ato.gov.au/atolaw/view.htm?Docid=PRR/PR200771/NAT/ATO/00001 (accessed 15 December 2014).

42 *Submission 34*, paragraph 56.

43 *Submission 34*, paragraph 57.

44 *Submission 60*, Appendix 1, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', p. 5.

believing that having purchased a scheme with a product ruling they were 'safe'. He explained:

> The tax office did nothing to dissuade them from the error of this view. The tax office did nothing—to my knowledge, anyway—about checking whether or not the schemes were run in accordance with the product ruling once they were established.[45]

4.34 Consistent with these observations, many investors who wrote to the committee understood, or were led to understand, that the ATO's ruling provided assurances about the commercial soundness of the scheme. As one investor stated: 'it was implied that due to the tax arrangements associated with the scheme they were government endorsed!'[46]

4.35 The matter-of-fact way investors spoke of their scheme revealed the genuinely held assumption that the government had given its support. For example, one investor contended that surely by 'investing for the future through government endorsed schemes, our retirement would be dependably secure'?[47] Similarly, another couple who invested as individuals and not through their company noted:

> …who in their right mind would think that these companies fully approved by the Australian Government for tax saving investment and properly screened by ratings companies and our accountant would go into liquidation that very year. Not only take the investment and not even bother to plant the so called harvest.[48]

4.36 Likewise, Mr David Lorimer was convinced about the legitimacy and soundness of his investment. His accountant introduced him to the schemes, which were presented 'as long term financially secure investments'. Furthermore, Mr Lorimer was led to suppose that, due to the tax arrangements associated with the schemes, they were government endorsed.[49] Another investor, Mr Michael McLeod, told the committee:

> I was provided with many glossy brochures, and the forecast returns looked healthy plus the scheme was endorsed by the ATO with the tax credits which made my decision to sign up seem like a good idea. I was happy that I was doing something positive with my money and taking charge of my

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45 *Proof Committee Hansard*, 5 August 2015, pp. 3 and 4.

46 Mr David Lorimer, *Submission 55.* See also Mr Alexander McShane, *Proof Committee Hansard*, 6 August, 2015, pp. 3–4 and name withheld, *Submission 69*, p. 1.

47 *Confidential Submission 37*, p. 13.

48 Ms Barbara Gray, *Submission 54*, p. [1].

49 *Submission 55*, p. 1. See also *Submissions 57*, p. [1]; *64*, p. [2]; *68*, p. [1]; *70*, p. [1]; *81*, p. [1]; and *87.* Name withheld, *Submission 103; Submission 133*, p. 1; and *Confidential Submission 8*, p. [1]; *Confidential Submission* 80, p. 3; *Confidential Submission* 92, p. [2].

> future to look after my family so as I didn't have to rely on Government handouts during my retirement years.[50]

4.37 Mr David Huggins, a legal practitioner representing a grower, maintained that the tax arrangement lured people into making 'what was in reality, a highly speculative investment'.[51] Mr Samuel Paton, principal of an agricultural consulting evaluation firm, similarly explained that unfortunately:

> …the hapless lay investor who was putty in the hands of the unscrupulous financial planners, receiving 10% commissions from the promoters assumed the ATO Ruling was a 'tick' for scheme viability.[52]

4.38 Thus, although the tax incentive may not have been the primary objective for some investors, many of them were reassured by the fact that, in their view, the ATO had endorsed the MIS and hence had confidence to invest in the product.[53] Investors often drew additional comfort about the security of the schemes from an understanding that ASIC had also approved them.

Registration of MIS and required PDS—perceived endorsement

4.39 ASIC must register an MIS within 14 days of lodgement of the application for registration, unless it appears to ASIC that the application or the proposed scheme is deficient with respect to a number of requirements. These requirements go mainly to governance or administrative matters such as the scheme's constitution and compliance plan having to meet statutory obligations. Some investors formed the view that a scheme's registration meant that ASIC had in some way vetted the scheme and given its backing. They also interpreted the publication of prospectuses and product disclosure statements as an indication that ASIC had vouched for the schemes. But, according to CAMAC:

> Whatever view of the law is taken on these matters, ASIC is not required to assess the commercial merits of a scheme.[54]

4.40 Many investors assumed otherwise.

4.41 In 2001, ASIC informed the committee that it had gone to great lengths to explain that it does not approve prospectuses: that it does not register these documents. It explained:

> There is an argument that says that the lodging of a prospectus with the regulator seems to create the impression in the minds of some investors that

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50 *Submission 87*, p. 1.

51 *Submission 118*, p. 6.

52 *Submission 149*, p. 3.

53 See, for example, name withheld, *Submission 150*, pp. 1–2.

54 Corporations and Markets Advisory Committee, *The establishment and operation of managed investment schemes*, Discussion paper, March 2014, p. 42.

> the regulator has had a role to play in somehow giving it a tick or otherwise …The disclaimer that is put in the prospectus, which at the moment says 'ASIC takes no responsibility for the contents of this prospectus', might in fact in some perverse way create the impression: 'That means they must have looked at it, if they are excluding their liability'…But the whole path down which the law is going is that it is a disclosure based regime and that the investor is supposed to make their own due inquiries, et cetera. It is not a regime that we designed, of course, but it is something that we would implement.[55]

4.42 Recently, ASIC informed the committee that, through media releases, consumer warnings, its consumer website, speeches and media commentary, it regularly and consistently warns consumers that it does not 'approve' investments, including agricultural MIS schemes. For example, currently on its MoneySmart website ASIC has issued the following warning:

> Be aware that a licence from ASIC does not mean that ASIC endorses the company, financial product or advice or that you cannot incur a loss from dealing with them. ASIC does not approve business models. ASIC grants a licence if a business shows it can meet basic standards such as training, compliance, insurance and dispute resolution. The business is responsible for maintaining these standards. Checking ASIC's databases should be only one of the many checks you should do before you invest your money.[56]

4.43 Even so, ASIC noted its concern that some retail investors might wrongly conclude from the existence of a PDS or prospectus and the operator holding an AFS licence that the government regulator had undertaken some checking and 'the disclosure was sufficient and the schemes being operated were commercially viable'.[57]

4.44 Despite ASIC's attempts to correct the false impression that a registered MIS has the regulator's imprimatur, some investors remained convinced that ASIC had endorsed their scheme. For example, one grower explained that the 'key selling point' was ASIC and the ATO's approval as a genuine, 'sanctioned' investment.[58] Another stated that she was one of a group people who believed that if an investment had a PDS then 'that was a stamp of approval by ASIC' as was the tax ruling.[59] Another

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55 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.33. Also refer to discussion on PDSs and lodgement of notification with ASIC in this current report, paragraph 9.16.

56 ASIC's MoneySmart website at https://www.moneysmart.gov.au/tools-and-resources/check-asic-lists and https://www.moneysmart.gov.au/tools-and-resources/check-asic-lists#prospectus (accessed 7 October 2015). See also ASIC, answer to written question on notice, No. 1, 2 October 2015.

57 ASIC, answer to question on notice, No. 3, 2 October 2015.

58 Name withheld, *Submission 95*, p. [1].

59 Name withheld, *Submission 151*, p. 5.

investor assumed that the scheme in which he invested was ASIC 'sanctioned'. He observed:

> ASIC have been more than useless; they have endorsed corrupt, unethical and unconscionable conduct. Great Southern was a fully endorsed product. Whichever government agency that…endorses financial products on offer in the marketplace did not do their job well enough to identify that Great Southern was essentially a ponzi scheme.[60]

4.45 A couple, who also likened the MIS to ponzi schemes, wondered how the projects ever got ATO approval in the first place.[61] In their view, not even ASIC or the ATO put enough research into these investments before approving them.[62] One couple indicated simply that they thought they were investing in 'a nice, safe investment, a product that was endorsed and supported by Australian Government legislation, and that nothing could go wrong'.[63] As another example, one investor asked:

> How is it possible for ASIC and the ATO to assess and give approval for such a financial scheme (were they deceived as well?), only to find that within 18 months it turned out to be [a] Ponzi scheme where hundreds (thousands?) of investors lost hundreds of millions of dollars, some of whom will go bankrupt and for a bank to cash in on this misrepresentation?[64]

4.46 Speaking for his wife, one submitter informed the committee that she had assumed Timbercorp was legitimate—'fully supported and endorsed investments by the government, ATO and ASIC…and therefore relatively safe'. Otherwise, he explained, his wife would never have considered buying into these investments.[65] He contended that steps should be taken to ensure that a false impression is not created, advocating that greater prominence be given to the fact that ASIC or the ATO take no responsibility for the contents of the PDS and do not endorse or support its content.[66]

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60 Name withheld, *Supplementary Submission 52*, p. 2.

61 *Confidential Submission 36*, pp. [1] and [5].

62 *Confidential Submission 36*, p. [5].

63 Name withheld, *Submission 56*, p. [2].

64 Name withheld, *Submission 91*, p. 3.

65 Mr Stefan Kaiser, *Submission 107*, p. 5. See also, *Submission 56*, p. [1]; *Submission 114*, p. 1; and name withheld, *Submission 150*, p. [2].

66 Mr Stefan Kaiser, *Submission 107*, p. 20. Mr Kaiser was supporting a recommendation by Willemsen, R. 2010, Submission to ASIC, 'Consultation Paper 133: Agribusiness Managed Investment Schemes: Improving Disclosure for Retail Investors'.

Committee view

4.47 The concerns raised in 2001 about the possible mis-selling of agribusiness MIS were well founded. In the following years, many growers mistakenly formed the view that the ATO had vouched for the viability of the schemes.

4.48 The ATO's effort to ensure that investors understood that it did not vouch for the commercial viability of agribusiness MIS, was undermined by a totally different perception that took hold in the minds of a number of retail investors. It would appear that some product issuers and financial advisers allowed, or even encouraged, investors to assume that an ATO product ruling meant government endorsement of the commercial viability of the product. A similar misunderstanding gained currency about ASIC giving its support to the schemes. Thus, growers mistakenly assumed that the products had ATO and ASIC approval and hence were deemed to be safe and suitable for retail investors.

Recommendation 1

4.49 The committee recommends that the ATO undertake a comprehensive review of its product rulings to obtain a better understanding of the reasons some investors assume that an ATO product ruling is an endorsement of the commercial viability of the product. The results of this review would then be used to improve the way in which the ATO informs investors of the status of a product ruling.

4.50 The committee recommends that the ATO and ASIC strengthen their efforts to ensure that retail investors are not left with the impression that they sanction schemes, including the use of disclaimers prominently displayed in disclosure documents including PDS.

Chapter 5

Geared investment

I was promised I would never use one cent of my money.[1]

5.1 Long after their collapse, the legacy of failed agribusiness MIS continues to cause untold trouble for some investors. Recent developments have not only shed light on familiar deficiencies in the marketing and operation of these schemes but have brought to light even greater flaws especially around the borrowing arrangements investors used to finance their venture. Indeed, for many investors the loan agreements they entered into to fund their MIS have compounded their problems.

5.2 In this chapter, the committee recognises that when growers combined leverage and investment, they exposed themselves to higher risk, as gearing accentuated any loss stemming from the failure of the investment. Cognizant of the increased risk, the committee looks closely at the way in which agribusiness MIS promoters and financial advisers arranged finance for the investors.

History of predatory lending

5.3 Before the committee starts its consideration of the financing arrangements offered to investors, it refers back to its June 2014 report which dealt comprehensively with the emergence of poor lending practices from about 2000 to 2008/09. At that time, the committee concluded that since 2002, and undoubtedly well before, some unscrupulous people in the financial services industry in Australia exploited inadequate consumer credit laws to engage in imprudent, even predatory, lending activities.

5.4 In summary, the committee found vulnerable people were targeted and encouraged to take out loans they could ill afford, potentially placing their home ownership in jeopardy. In many cases, the unwitting borrower discovered later that information on their loan application forms had been fabricated and signatures forged. The committee concluded that such practices, which were allowed to continue unchecked for many years, reflected badly on the brokers, the lenders and ASIC. It highlighted the vulnerability of unwary and trusting borrowers, who were taken advantage of by unprincipled and self-interested brokers and lenders. It should also be noted that the committee referred to the improper lending practices associated with Storm Financial and the ensuing harm caused to investors when that company collapsed. Notably, these irresponsible lending practices emerged and took hold

1 Cited in Ms Kathleen Marsh, *Submission 47*, example 2, p. [1].

during the period that growers were also taking out loans to fund their investments in agribusiness MIS.[2]

Investment lending

5.5 A significant number of growers used borrowed funds to purchase their interest in MIS projects. In many cases, entities associated with the RE provided direct finance to growers, while other growers entered into their own arrangements with financial institutions to obtain finance.[3] The committee's focus in this chapter is on the financing arm of the respective RE that provided funds for the schemes' investors and the advisers who facilitated the loans.

5.6 In the context of these schemes, Mr Mark Rantall, Financial Planning Association (FPA), spoke of 'a cocktail of structure' that really came into play when leverage was added to an already complex financial product. Put simply, when the schemes failed to perform to expectations, people who were over-leveraged had 'a real problem' meeting their repayments.[4] Thus the anguish and financial loss suffered by those who had invested in the failed schemes was compounded many times over by the loans they took out to fund their venture. Not only were they left with a worthless investment but a sizeable loan and interest that had to be repaid. Their distress was epitomised by one couple who stated:

> It was crushing enough to know the MIS projects would never mature as promised in time for our retirement, but absolutely gut-wrenching to then be informed we had taken out 12 huge loans from Timbercorp Finance. We were in total disbelief seeing an amount of approximately $240,000 owing at the time of collapse.[5]

5.7 A number of growers now burdened with a debt for which they had nothing to show also faced increased interest rates and some, on legal advice, stopped making repayments on their loans.

Cash flow negative/positive

5.8 The FPA noted that the lending arrangements were wrapped into the agribusiness investment and that they evolved over time.[6] It explained further that the arrangements could have been principal and interest; interest only; and:

> …ultimately, towards the end of the MIS situation, those products often morphed into something where there was an initial interest-free or interest-

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2 Senate Economics References Committee, *Inquiry into the performance of the Australian Securities and Investments Commission*, June 2014, chapters 5 and 6, paragraphs 6.1–6.7.

3 See *Non-forestry Managed Investment Schemes,* Issues Paper, 2008, paragraph 19.

4 *Proof Committee Hansard,* 6 August 2015, p. 25.

5 *Confidential Submission 37,* p. 2.

6 Mr Neil Kendall, *Proof Committee Hansard*, 6 August 2015, p. 25.

> only period, with principal and interest deferred. So it is not a static product per se.[7]

5.9 Tax concessions were generally a consideration in the total loan structure. From the Bendigo and Adelaide Bank's perspective, the tax treatment often formed 'an integral part' of an investor's 'tax and cashflow management strategies'.[8] The ANZ observed that borrowing may have assisted investors in Timbercorp 'to maximise taxation benefits'.[9] For example, one grower understood that in the short term he would not have much financial benefit from his investments, apart from a reasonable income tax return. This return, however, would never cover the MIS fees.[10] Mr David Huggins also saw the tax incentive in a different light from the banks and referred to the downside of these concessions for retail investors, submitting that:

> …the tax treatment of these financial products (being able to claim the amount invested as an *up front* tax deduction) served as a means to lure clients into making what was, in reality, a highly speculative investment—the issue being that the loan used to make the investment would have to [be] paid back with interest (for example in my Client's case in equal monthly instalments over a 15 year period) in circumstances where it was always highly doubtful as to what return would be received from the investment and when that return would be received.[11]

5.10 In essence, the borrowing arrangements allowed a retail investor, who did not have the funds, to borrow almost the total amount to finance their agribusiness venture. It was not uncommon for growers to borrow up to 90 per cent of the investment or gear their entire investment in agribusiness MIS.[12]

5.11 Typically, the loan was based on the assumption that the project would be cash flow negative for the first few years, then subsequent returns from the harvest proceeds would be used to pay down the debt.[13] Investors had no reason to suspect they would default on their repayments because of assurances that the cashflow from the harvest would pay off the debt and eventually produce a reliable and secure income stream. According to one such investor, he was shown 'clear forecasts'

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7 Mr Neil Kendall, *Proof Committee Hansard*, 6 August 2015, p. 25.

8 Bendigo and Adelaide Bank, Response to *Submission 52, Submission 63, Submission 175* and *Submission 176*, dated 24 December 2014, p. [3].

9 *Submission 145*, paragraph 33.

10 *Confidential Submission 37*, p. 4.

11 *Submission 118*, p. 6 (emphasis in original).

12 See, for example, name withheld, *Submission 102*, p. 1 and name withheld, *Submission 97*, p. [1].

13 There are numerous accounts of investors being led to believe that the scheme was designed to be initially cash flow negative with harvest proceeds then kicking in to become cash flow positive. See, for example, name withheld, *Submission 76*, p. 1; *Confidential Submission 59*, p. 1; *Confidential Submission 155*, p. 2; and *Confidential Submission 164*, p. [1].

indicating that 'after a few years there would start to be a small return and then the return would gradually grow later in the investment'.[14] Another investor explained:

> In order to access this product, Great Southern Investments was issuing loans to pay for the product. The product was supposed to provide a cash flow to pay for the loan, and eventually pay the loan off and provide a residual income once the loan had been paid off. As was recommended to us, I invested $42,900 (my wife invested $31,200).[15]

5.12 One grower gave a similar explanation of the rationale behind the loan structure:

> The project I entered into and borrowed money on was designed to be cash flow negative for the first 5 years, then harvest proceeds from [the] 6th year onwards, in my case around 2010/2011, become cash flow positive paying down the loan.[16]

5.13 Likewise, one couple informed the committee that the loans they would take out to fund the purchase were to be covered from years two onwards by the returns from the grapes as well as the Navra share fund. They stated:

> The first couple of years there would be [a] small shortfall until the Grapevine returns kicked in—but with the tax deductions we'd get from the product ruling (as this was supported by the government), plus the returns from his share fund this would be covered. It sounded like we couldn't lose.[17]

5.14 Mr Peter Mazzucato was presented with a similar loan structure for his almond scheme. He noted that in order to invest, he needed to take out a substantial investment loan with Timbercorp Finance, explaining:

> The way it was sold to me was that it would be cost flow negative for 2 years after which the income from the sale of the almonds would reduce the cost. The cost would become cash flow positive after about 4 years and then provide an income for 23 years. This really appealed to me so I was keen to go on board.[18]

5.15 Consistent with the experiences of many other growers, the mother of two young children was led to understand that her and her husband's loan arrangements would be self-funding:

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14 See, for example, name withheld, *Submission 94*, pp. [1] and [2].

15 Name withheld, *Submission 68*, p. 1.

16 Name withheld, *Submission 76*, p. [2].

17 *Submission 56*, p. [1].

18 *Submission 40*, p. [1].

> The short-term dividends would cover the loan repayments, and the long-term dividends would cover our retirement.[19]

5.16 The couple's goal was 'always long-term financial independence'—that is independence from government support as they aged.[20]

5.17 Generally, the loan, provided by the financing arm of the respective RE, was part and parcel of a total investment package so that poor, inaccurate, misleading advice and bad adviser behaviour carried over to the loan arrangements. Mr Jayantha Anthony noted that his accountant, who advised on the Timbercorp investment, also facilitated the refinancing of his properties so that he could get extra money to pay part of the Timbercorp loan owed.[21] Mr Dinu Ekanayake, who may have to sell the family home to meet his loan obligations, was under a misapprehension about the risks involved in the loan agreement for investing in MIS due, he reasoned, to misleading information:

> I have purely invested for this project based on Cash flow sheet which Timbercorp issued to all investors, they have not adequately showed the risks (it was an excel worksheet which was in their web site). According to that sheet we need to pay until 2013 and [the] rest of the loan term is self paid by the project proceedings.
>
> Then even [if] we lose, in this case we as investors were only liable to pay until 2013 as they have indicated in the cash flow sheet in their site. Other amount is to be covered from the project itself.[22]

5.18 On behalf of his client, a lawyer explained the arrangement his client entered into and why, in his opinion, it was inappropriate:

> (1) On 28 May 2009 and pursuant to financial advice provided to him by the Accountant, my client agreed to make the Investment and to borrow $229,200 to do so. In this regard, the Employee completed the Finance Package document on my Client's behalf so that finance could be provided by the CBA.
>
> (2) In my view, the Investment was grossly unsuitable (for multiple reasons) for my Client. In this regard, the Accountant failed to provide my Client with a Statement of Advice (contrary to the Corporations Act) in circumstances where a properly drafted Statement of Advice ('Statement of Advice') would have informed my Client as to the following matters:
>
> (i) that there was no reasonable financial justification for my client to make the Investment;
>
> (ii) the financing of the Investment would involve my Client locking himself into an arrangement whereby my client would be required to

19 Name withheld, *Submission 201*, p. [1].

20 Name withheld, *Submission 201*, p. [1].

21 *Submission 29*, p. 1.

22 *Submission 21*, p. 1.

pay back the loan used to make the Investment in monthly instalments (at an inflated interest rate) over a 15 year period;

(iii) that there were substantial (and multiple risks) associated with the Investment such there was a substantial risk that the Investment could fail leaving my Client in the position (which he now is in) of having to pay back the entire amount borrowed to make the Investment (with interest) over a 15 year period from his own resources; and

(iv) the Employee (and/or persons or entities associated with him) would receive $22,920 by way of a commission payment (that is, 10% of the amount invested by my Client—it may be that a higher commission payment was received—10% was the base amount of commission paid by these schemes).

(3) My client would not have made the Investment if he had been informed of any of these matters and, in particular, he would not have made the Investment if he had understood the size of the repayments he would have to make (over a 15 year period) [or] if he had understood that a commission payment of $22,900 would be received by the Accountant.[23]

5.19 For investors, this strategy of borrowing to invest in an MIS appeared reasonable on paper—that within three or four years they would break even and thereafter proceeds from the sale of the crops would take care of any repayments.[24] For example, according to one grower, his family did the research, read the product information given to them by their financial advisor, which all seemed positive. He explained:

> There were no questions raised as to the long term viability of this scheme. This investment was supposed to be long term with the profits helping us to pay off our loan with Timbercorp finance.[25]

5.20 Another grower noted that he initially borrowed about $70,000 to buy almond lots where the almonds would be grown and then harvested and sold for a return. He understood that the return would come gradually over many years. He stated:

> I was shown clear forecasts of this indicating after a few years there would start to be a small return and then the return would gradually grow later in the investment.[26]

5.21 Growers simply could not understand how they found themselves in a situation whereby they had to pay back a loan for something that no longer existed and, in some cases, was 'never even planted'.[27]

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23 David Huggins, Huggins Legal, *Submission 118*, p. 3.

24 See, for example, Mr John McDonald, *Proof Committee Hansard*, 12 November 2014, p. 3; and *Confidential Submission 37*, p. 4.

25 Name withheld, *Submission 18*, p. 1.

26 Name withheld, *Submission 94*, p. 1.

27 Name withheld, *Submission 98*, p. 1. See also *Submission 103*, p. 1; and *Confidential Submission 81*.

Borrowing for annual fees

5.22 Furthermore, under their agreement some growers were required to fund annual fees but were not made aware of this obligation. For example, one adviser reassured his client that no additional funds would be required 'as the profits made on the investment projects would maintain the management fees etc'. Similar to other accounts given to the committee, this adviser claimed that the scheme was presented as a low risk investment and the client should not be concerned about having to make repayments.[28]

5.23 One investor indicated that she had no idea of management fees until everything 'went bad', and there were loans with no source of funds to pay for them.[29] She was not alone in assuming incorrectly that the management fee for her scheme was a one-off payment. Mr Brett Lawtie received an account from Timbercorp for approximately $9,500 for the yearly maintenance of trees. He explained that he 'was paying for trees that had not been planted'. To make matters worse, his financial advisor had not informed him about this yearly ongoing fee.[30] In summary, Mr Lawtie stated:

> …we made about a year or so worth of repayments, for trees that were allegedly not planted, charged a yearly maintenance fee for trees that were allegedly not planted, and now being pursued by Korda Mentha on behalf of the ANZ bank, which we have been with for 30 years for an amount nearly $20,000 more than the original loan.[31]

5.24 One couple stated quite clearly that they were under the impression that the deposit and repayments of the $24,000 and $42,000 were the only payments they were required to make with the scheme becoming self-funding after about three years. But, according to the couple:

> This scheme was completely mis-represented to us in that Peter Holt [their adviser] neglected to advise us that there was also a management fee each year for a period of 15 years, being $12,000 per annum on the Mango trees and $22,000 on the avocado trees and probably escalating as the years go by.[32]

5.25 As at September 2009, and at the age of 70, they owed Timbercorp $130,000 in management fees with an ongoing liability of 13 years of fees still in the pipeline.[33]

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28 Name withheld, *Submission 153*, p. [2].

29 *Confidential Supplementary Submission 156.1.*

30 *Submission 1*, p. 1.

31 *Submission 1*, p. 1.

32 *Submission 43*, p. 2. See also *Confidential Submission 92*, p. [1]; *Confidential Submission 130,* p. [2]; *Confidential Submission 131*, p. 1.

33 Ray Wilde and Maree Wilde, *Submission 43*, p. 2.

Like so many others in similar positions, they faced being left with 'no money, no home and no prospect of a reasonable standard of living'.[34] As one grower observed:

> Maintenance costs were escalating dramatically and beyond my expectations.[35]

5.26 A number of these highly leveraged investors found themselves caught in a trap of having to borrow further to pay for annual fees. Some investors did not understand that the yearly management fees would become additional loan commitments 'to sustain the overall investment'.[36] In this regard, it would appear that the practice of re-financing loans to pay for annual outlays was commonplace, which pushed some growers further into debt.[37] For example, one such investor received a bill from Timbercorp Finance to the tune of $10,000 for ongoing costs of maintaining the plots, which 'came out of the blue and was completely unexpected'. He explained:

> Not having this sort of money, I had no choice but to accept Timbercorp finances offer of a loan to repay the money each month which added to my cost for this scheme each month.[38]

5.27 Another grower explained that on his adviser's suggestion, his management fee of approximately $26,000 was taken as a separate loan for tax advantages.[39] Along the same lines, another investor informed the committee that she was not told that she needed to take out further loans for management fees nor did she understand the implications of this MIS.[40] Yet another stated that management fees meant 'additional loans through Timbercorp Securities at a later date'.[41] A 54-year old father of three was under the same misapprehension. He stated that a couple of months after signing the contract, he received a bill for approximately $18,000 for operational costs. In his words:

> I was so shocked as no one had mentioned that to me!! I didn't want to take out a further loan so paid this amount upfront. Then another few months later I received another bill for around the same figure!! I did not have the cash to pay this one up front, so had no choice but to take out another loan with Timbercorp.[42]

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34 Ray Wilde and Maree Wilde, *Submission 43*, p. 6.

35 Ms Sandra Cordony, *Submission 169*, p. 4.

36 Mr Troy Lott, *Submission 101*, p. [1]; name withheld, *Submission 131*; *Confidential Submission 156*, p. [2].

37 Mr Troy Lott, *Submission 101*, p. [1]; name withheld, *Submission 131*; *Confidential Submission 156*, p. [2].

38 Mr Shane Richards, *Submission 108*, p. [1].

39 Mr Ken Grech, *Submission 123*, p. 1.

40 *Confidential Submission 38*, p. 1.

41 Ms Michelle Johnson, *Submission 139*, p. [1].

42 Name withheld, *Submission 103*, p. 1.

5.28 His case typifies the experiences of many others whereby the investment arrangement was structured in such a way that additional funds would be required to cover ongoing maintenance fees and associated operating costs often resulting in a refinancing of the loan.

5.29 One couple explained that they did not want to over stretch themselves so decided to borrow $45,000 to fund the $50,000 investment in five almond lots, which in their assessment was something they 'could do easily'.[43] A month after being accepted into the almond scheme, this particular couple received an invoice for $10,000 towards maintenance cost for the year (2008–2009), for which finance was again organized through Timbercorp finance.[44]

5.30 Likewise, another couple, who borrowed money to invest in almond trees, received a letter for a management fee for their almond lots of $12,700. They stated:

> We did not have this money so had to re borrow from Timbercorp Finance. The loan agreement date was the 28th October 2008.[45]

5.31 Another investor had a similar arrangement whereby he borrowed more money to pay for yearly maintenance fees. He explained that in September 2008, he received an invoice for the 2008 licence fee and management costs which equated to $19,800, payable by 31 October. Put simply:

> Again I had no choice but to borrow from Timbercorp to cover these costs.[46]

5.32 The cumulative effect of these management fees and maintenance costs was substantial for retail investors. For example, only a few months after becoming a grower, one investor discovered that she had to pay additional costs for the maintenance of the plantations. Subsequently, two more loans of $30,000 each were added which made the repayments onerous but her adviser explained that 'this was just the way the scheme was set up and that it would all be ok'.[47] Indeed, one grower wrote of his surprise at having to fund considerable annual fees:

> What the prospectus did not detail, nor my financial planner point out, was that there were significant, if not outrageous annual growers' fees to be paid, so outrageous that I kept having to borrow more money each year to pay them.[48]

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43 Name withheld, *Submission 97*, p. [1].

44 Name withheld, *Submission 97*, p. [1].

45 Mr Troy Lott, *Submission 101*, p. [1].

46 *Name withheld, Submission 98*, p. 1.

47 *Confidential Submission 81*, p. [2]. It should be noted that in this case the adviser has been convicted of theft from a client and ASIC and Association of Financial Advisers (AFA)have barred her for life from providing financial advice, but, as noted by the investor, all came too late for her and the rest of the adviser's clientele.

48 Name withheld, *Submission 96*, p. 1.

5.33 Mr Peter Mazzucato, who purchased three investments, each with a loan attached for a total of $111,000, also learnt that he had to pay additional costs for the maintenance of the plantations. He explained that although the repayments and fees were becoming a burden, he had reliably paid the investment each month as required paying off approximately $30,000. He comforted himself with the fact that 'in only another year or so, I would have an income which would offset the loan'.[49] But the anticipated income from the investment that 'was going to provide relief did not eventuate' and, instead, he found himself with a huge debt and no income.[50]

5.34 As a final example, but still only one of many, an investor explained the 'rude shock' she received when the first invoice arrived. In her words:

> The accountant knew I would get this invoice and when I called up to query why I had received it, he just advised me that I had paid the initial investment amount in June, but that this was the management fee, 'Just sign up for another loan through Timbercorp'. This was fully expected by him, and yet no-one had made this clear to me before I signed up.[51]

5.35 According to the investor, the loans, including funds used to pay for the unexpected annual fees, 'were passed off as if they were "de rigeur"—just part of the investment…'[52]

Approval process—loan application forms

5.36 For investors, trust played a central role in their decision to invest in an agribusiness MIS including entering into loan arrangements to fund their investment. But it would appear that in some cases this trust was misplaced. A number of investors cited irregularities in the process for arranging their loan such as signing incomplete or blank application forms and not receiving documentation.

5.37 Examples of other anomalies included the adviser inserting inaccurate statements, such as inflated income and underestimated liabilities, in application forms. As one submitter, who invested in Great Southern, described:

> The loan documentation was filled in by my advisor in which I stupidly signed, however there were many areas that were left blank (and probably filled in later by the advisor to get the loan through). It was obvious by my level of earnings that I would not be able to pay the loan and the only way to pay the loan was by selling my house. I received no documentation stating as to what was going on as all correspondence was sent to Peter Holt

49 *Submission 40*, pp. [1]–[2].

50 *Submission 40*, p. [2].

51 Name withheld, *Submission 151*, p. 2.

52 Name withheld, *Submission 151*, p. 6.

> who did not pass this correspondence on—that is if there was any documentation.[53]

5.38 One investor described how her husband signed blank forms, which his financial adviser filled in but the details were falsified. She recalled that the adviser 'filled in my sole trader ABN form and forged my signature'.[54] Yet another stated that his long time accountant helped him fill out the loan application forms, which, in the accountant's handwriting, made reference to high incomes. According to the investor, there were two such entries that were 'obviously untrue'. The submitter contended that his accountant should have known otherwise when he made those statements regarding income status.[55]

5.39 Ray and Maree Wilde referred to their loan documentation relating to finance for a 2007 Avocado scheme, which contained gross understatements in relation to liabilities and expenses—loans of $200,000 when, at the time, they were $534,586; living expenses recorded as $15,000 in that financial year but were $47,897.[56] Mr Troy Lott spoke of being given blank loan documents to sign, which his adviser indicated he would fill in later.[57] Similarly, another grower indicated that his documents were mailed out to him to sign, requiring him to fill out or arrange proof of his particulars.[58] Another cited documentation that was incomplete, inaccurate and/or falsely witnessed.[59] Mr Peter Mazzucato explained the loan process:

> We arranged for a meeting in the following weeks to then conduct a questionnaire so that he could provide a statement of advice. The planner coached me through the questionnaire so that my profile matched the requirements for the investment. I was totally naive to why this was necessary. I did not realise that he was protecting himself by being seen to be compliant. As I did not think that there was any risk, it was simply a formality that required to be done to expedite the loan.[60]

5.40 One of the most troubling allegations concerned investors being unaware of loans taken out in their names.[61] Some claimed that although they understood they had

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53 *Confidential Submission 38*, p. 1. See Mr Con Solakidis, who stated the documents mailed out to him did not require him to 'to fill out or arrange proof of particulars of myself or have anything witnessed. I was just asked to sign where the Yellow tabs indicated to sign'. *Submission* 119.

54 Name withheld, *Submission 162.*

55 *Confidential Submission 39,* p. 2.

56 *Submission 43*, pp. 2–3. See also, name withheld, *Submission 121*, p. 1; name withheld, *Submission 162*, p. [1]; *Confidential Submission 93,* p. [1].

57 *Submission 101,* p. [1]. See also name withheld, *Submission 186*, p. 4.

58 Mr Con Solakidis, *Submission 119*, p. [2].

59 *Confidential Supplementary Submission 156.1*, p. [6].

60 *Submission 40*, p. [1].

61 See name withheld, *Submission 100*, p. 8; and name withheld, *Submission 121*.

signed for one or two loans they were tied to multiple loans.[62] Mr John McDonald explained his bafflement on discovering that he had 12 loans when he had only bought five Timbercorp products:

> Apparently the forms I was signing, I later learnt, were not just buy-in forms but were loan applications. I was borrowing money I did not know I was borrowing. It can be argued that I signed these forms and no-one held a gun to my head. Some will argue that there is a loan application and it has your signature on it, so it is a loan application. It is hard to argue against that, except for the fact that it all came down to trust over years—two decades even—of signing forms without having to read them and having total faith in the financial adviser. I had got into that bad habit.[63]

5.41 A group of investors suggested that all loan correspondence was sent to their financial adviser, a Mr Peter Holt, at his office address and not received directly by them at any time.[64] Mr Bernard Kelly, a client of Mr Holt, also told the committee that he had five loans, which he did not know existed. He indicated that other people filled in most of the information on the loans, which were signed by witnesses he did not know.[65] A third client of Mr Holt, experienced the same situation. In this case, the couple signed what they thought were three loans for Timbercorp, but discovered they had eight.[66] Yet another of Mr Peter Holt's clients indicated that all documentation from Timbercorp was sent to the offices of Holt Norman Ashman Baker & Company and he did not see copies of the loan documents.[67]

5.42 One investor referred to their loan documents as 'incomplete, pieced together and addressed to his adviser's office'. A financial adviser who gave evidence stated that clients were asked to sign 'blindly and with no-follow-up'.[68] According to another submitter who was also rushed to sign documents to invest in Timbercorp:

> …our Adviser never gave us a Statement of Advice and he had no authority to proceed with the investment, we received the SOA 18 months later and we signed a backdated 09/June 2004 SOA in December 2005, we totally trusted them we thought they were looking after us we know now that instead they were only lining their own pockets.[69]

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62 For example, one investor stated that he thought he had signed for two loans but found he had five owing over $200,000. Name withheld, *Submission 121*, p. 1.

63 *Proof Committee Hansard*, 12 November 2014, p. 3.

64 *Confidential Submission 154*, pp. [2] and [3].

65 *Proof Committee Hansard*, 12 November 2014, p. 4.

66 Mrs Meredith Byrne, *Proof Committee Hansard*, 12 November 2014, p. 5.

67 Name withheld, *Submission 93*, p. [2].

68 Mrs Kerree Bezencon, Chair, Timbercorp Grower Group, *Proof Committee Hansard*, 12 November 2014, p. 40.

69 Name withheld, *Submission 45*.

5.43 Granting a power of attorney to advisers could offer a partial explanation for how investors could unknowingly enter into a loan agreement.

Power of Attorney

5.44 In its 2014 discussion paper on the establishment and operation of managed investment schemes, CAMAC observed:

> To assist the RE in acting as agent for scheme members, it has been the practice with some common enterprise schemes for the application form signed by any person seeking to become a scheme member to contain a grant of a power of attorney to the RE.[70]

5.45 According to the evidence, investors, in some cases, signed over a power of attorney, which their adviser then used to arrange loans. A number of submitters suggested further that they were required to sign a power of attorney in order to obtain the finance to secure their vinelots.[71] One couple explained that in October 2008 they were issued with another loan through Timbercorp Finance to pay the management fees for the following year. They claimed:

> We never filled out an application for the loan, it was regarded as part of the ongoing finance package, at no stage prior did we receive any documentation to review before or after they were signed under power of attorney? We did receive an explanation and terms for this loan after the event. We then made 11 of the monthly payment instalments, at which point the Timbercorp Group of companies went into liquidation.[72]

5.46 One couple referred to their adviser's use of power of attorney and how they were kept in the dark about subsequent loans:

> We were unaware of the specifics regarding subsequent borrowings in our name following our initial investment. Subsequent borrowings were authorized by a Power of Attorney that we knew nothing about and that was obtained deceitfully. We had no discussion, agreement or informed consent in regard to a Power of Attorney.[73]

5.47 Recounting a similar experience, another investor stated that he first sighted the loan agreement, signed on his behalf by two Great Southern directors, approximately nine months after he signed the application form in the PDS—the only document bearing his 'physical signature'. He explained that his financial adviser completed the application form and mailed it through to Great Southern Finance:

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70 Corporations and Markets Advisory Committee, *The establishment and operation of managed investment schemes*, Discussion paper, March 2014, p. 18.

71 Name withheld, *Submission 91*, p. 2. See also name withheld, *Submission 61*, p. 1; name withheld, *121*, p. 1; and *Confidential Submission 80*, p. 5; *Confidential Submission 85*; *Confidential Submission 92*, p. [1].

72 Name withheld, *Submission 95*, p. [2].

73 *Confidential Submission 134*, p. [2]. See also, *Confidential Submission 59*, p. [2].

> The Loan Deed was later 'executed' on my behalf under a POA [power of attorney] by inserting 'pictorial' signatures of Messrs Young and Rhodes.
>
> …
>
> At no stage during this process was I afforded the opportunity to review the Loan Deed (and carefully consider any onerous clauses) executed on my behalf. A copy of the Loan Deed was simply mailed to me as a fait accompli under the POA.[74]

5.48 Ms Naomi Halpern, spokesperson, Holt Norman Ashman Baker (HNAB) Action Group, told the committee that recently she obtained all her loan documents from Timbercorp, which she had never seen. She then learnt her adviser had power of attorney:

> That is how he was able to put me into several loans over several years. It was witnessed by someone I had never met.[75]

5.49 Based on its knowledge of agribusiness MIS, ASIC informed the committee that:

> …REs may require a Power of Attorney to be provided in order to allow the RE to enter into a variety of agreements and leases on behalf of the investor to give effect to the scheme.
>
> The use of Powers of Attorney in this manner is practical in nature, as it would be expensive and impractical to expect a grower to enter into individual management and lease agreements with all the parties concerned.[76]

5.50 ASIC noted, however, that it has published on its MoneySmart website the following advice: 'Power of attorney warning—Don't give your adviser power of attorney. Reputable advisers won't ask you to do this'.[77] The Financial Planning Association (AFP) stated emphatically that granting a power of attorney to an advisor to sign someone into a loan should not be a practice at all: that it was inappropriate.[78] Powers of attorney are governed by state legislation.

Committee view

5.51 It is difficult to comprehend how the financial services industry in Australia could have tolerated such lax and, in some cases, unethical lending practices. They included exposing clients to unacceptable levels of risk; withholding vital information and documents; falsifying documents; locking clients into lending commitments they

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74 Name withheld, *Submission 44*, pp. 2–3.

75 *Proof Committee Hansard*, 12 November 2014, p. 8.

76 ASIC, answers to question on notice, No. 3, 2 October 2015.

77 ASIC, answers to question on notice, No. 3, 2 October 2015.

78 Mr Neil Kendall, *Proof Committee Hansard*, 6 August 2015, p. 26.

did not understand and, in some cases, did not consent to; and improper use of a power of attorney. But instances of this conduct in the agribusiness MIS sector provides yet another example of poor behaviour, including predatory lending, evident in Storm Financial and Opes Prime and the infamous low doc loan saga described at length in the committee's 2014 report.

Irresponsible lending

5.52 Based on the evidence, investors were allowed to borrow a substantial proportion of the loan—90 to 100 per cent for example.[79] Even those who clearly indicated that they were not in a strong financial position were encouraged to borrow. Many of the investors argued that they should never have been granted a loan: that their financial circumstances indicated that the repayments were beyond their means. They asked about the lenders' due diligence obligations.

5.53 One couple explained that they would not have been able to afford to take on the investment, even if they wanted to because, as their tax returns bear out, they had jointly earned $82,000 in 2005 and $95,000 in 2006. Their adviser's recommendation was that they invest $126,000 in the 2007 scheme between them, all funded via Great Southern Finance.[80] In their situation, the loans were unaffordable or irresponsible. It was not, however, an isolated case. Mr Andrew Peterson, former general manager of distribution at Timbercorp, was of the view that many of the investors should never have qualified for a loan:

> If you were going for an individual loan at Timbercorp Finance, all you had to put in was your individual pay slip and your assets and liabilities. There was no request for a rates notice, no request for an ITR, a tax return… Timbercorp Finance was approving it very quickly.[81]

5.54 He contrasted this practice with that of the bank where, as an example, a client going to the ANZ for $100,000, would be asked 'for a rates notice if you own property, your ITR [income tax return], everything'.[82] Evidence also brought to light other irresponsible even negligent lending practices.

Full recourse loans

5.55 All of Timbercorp Finance's loans were 'recourse'.[83] A recourse loan holds the borrower personally liable. With a recourse loan, repayment may come from the

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79 Name withheld, *Submission 97*, p. [1]; name withheld, *Submission 102*, p. [1]; *Confidential Submission 36*, p. [8]; *Confidential Submission 81* and see paragraph 5.4.

80 Name withheld, *Submission 56*, p. [1]. See also name withheld, *Submission 100*, p. 11.

81 *Proof Committee Hansard*, 12 November 2014, p. 13. Mr Peterson was general manager of distribution at Timbercorp from September 2004 to December 2009.

82 *Proof Committee Hansard*, 12 November 2014, p. 13.

83 KordaMentha, additional information on behalf of Timbercorp Finance, dated 4 December 2014, p. 5.

proceeds of the asset being financed or the sale of specific collateral, or from the resources of the borrower if, as in the case of some agribusiness MIS, the scheme's cash flows proved insufficient. In other words, lenders could pursue the borrower for the outstanding amounts owed—even after the lender has taken collateral. Thus, if a borrower defaults on a recourse loan, the lender can bring legal action against the borrower, garnish wages, levy bank accounts, and use other methods to collect the amount owed.[84]

5.56 For the growers, their full recourse loan meant that their personal assets could be used to discharge their debt if they were in default of their loan—that the collapse of their scheme did not relieve them of their obligations under these loans.[85]

Understanding risks of recourse loans

5.57 In 2010, a group of researchers pointed to the nature of agribusiness MIS loans whereby the scheme operator provided 'full recourse', high debt-to-investment ratio loans to investors to fund their venture or arrange such loans. They noted:

> Sophisticated investors may be aware of substantial risks associated with the investment such that project returns may be inadequate to repay obligations on such a loan. But such loan-investment packages are not always *marketed* as 'high risk' (despite disclosure of the risks).[86]

5.58 According to ASIC, the fact that these loans were full recourse is significant because:

> …it indicates that the risks associated with the investors' 'property' resulting from the actual investment in the forestry scheme were perhaps too great for financiers. This resulted in them seeking alternative security from the borrowers.[87]

5.59 Some investors were not only unaware that a full recourse loan usually indicated higher risk but that they had entered into such a loan. Indeed, many of the borrowers suggested that they did not fully comprehend the loan arrangements with many assuming that the loan was held against the actual investment and thus their liability was limited to the trees or plants. According to one couple, their loans were

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84 Internal Revenue Service, 'Recourse vs. Nonrecourse Debt', http://apps.irs.gov/app/vita/content/36/36_02_020.jsp; Law Dictionary: What is full recourse loan? (Black's Law Dictionary), http://thelawdictionary.org/full-recourse-loan/ and NAB's website, http://www.nab.com.au/personal/loans/personal-loans/super-lever/limited-recourse-borrowing (accessed 3 December 2014).

85 *Submission 34*, paragraph 59.

86 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 10, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (9 December 2014).

87 *Submission 34*, paragraph 60.

obtained fraudulently without being alerted to the fact that their personal assets were exposed to the risk of being used to discharge their debt in the event of default.[88] In some cases, growers indicated that they were misled and told that the loans were non-recourse.[89] For example, an investor with Great Southern stated that her adviser led her to assume that GS would loan her the money and, importantly, that it was a limited recourse loan. She has since learnt that 'the loans were never limited recourse (despite being assured they were), the lender was not GS but Bendigo Adelaide Bank and for my own financial security I should have been screened according to ordinary lending scrutiny/practices'.[90] She explained further:

> Had I received the loan application form I would have at least had the chance to learn this! I would have also liked to have the opportunity to fill out the paperwork and my understanding of it.[91]

5.60 A number of submitters referred to the assurances they were given that their home would not be at risk: that the security was confined to the asset tied to the loan.[92] For example, one submitter informed the committee that they were told they were borrowing from Timbercorp and had to put their Timber Lots and Almond Lots as collateral but it was never mentioned that they were borrowing from any banks or putting their house in jeopardy.[93] Another couple certainly had no idea that if the grapevine returns failed to materialise they would 'lose title to any assets and have to pay the loans anyway, including interest and penalties'.[94]

5.61 Another couple stated that initially they were very wary of investing and asked many questions. They were assured that there was no personal risk, everything was fully insured and that their homes would never be 'on the line' as the trees themselves were collateral for the investment. The couple now live in fear of being sued.[95]

5.62 One investor was told that should the investments fail there would be nothing more to pay. He noted that Great Southern employees actually stated this in the information sessions.[96] Another stated that his understanding was that the loans were secured against the agricultural land and future income from the crops and, hence, he

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88 *Confidential Submission 134*, p. [4].

89 *Submission 109*, p. 1; Mr Brad Pearce, *Submission 111*, p. 1; name withheld, *Submission 168*, p. 1; *Confidential Submission 125*, p. [1] and Mr Neil White, *Proof Committee Hansard*, 12 November 2014, p. 32.

90 Name withheld, *Submission 52*, p. 1.

91 Name withheld, *Supplementary Submission 52.1*, p. 2.

92 *Confidential Submission 115*, p. 3; *Submission 95*, p. [1].

93 Name withheld, *Submission 45*, p. 1.

94 Name withheld, *Submission 56*, p. [2].

95 Name withheld, *Submission 95*, p. [3].

96 Name withheld, *Submission 168*, p. 1.

'was not exposed to being left with zero assets or zero income and then having to repay these loans personally'.[97] On behalf of her clients, who had invested in Great Southern, Mrs Susie Bennell stated that, without exception, they were reassured by their advisers that their homes would 'always be safe'.[98] Many investors were under the same misconception.

5.63 Clearly, these borrowers felt that their adviser had 'badly misled' them by indicating that the loans were non-recourse.[99] In their view, they should have been made aware of the risks. One grower suggested that the real risk of being exposed to debt recovery should the MIS collapse was obscured from them. They explained:

> The inherent risk associated with the taking out of a loan was never talked about in our meeting because we understood the investment we had made provided us with an asset to trade our way out of trouble if it eventuated.[100]

5.64 One investor also spoke of the adviser's failure to disclose risks that, in the grower's view, were 'high and many'.[101] He suggested that some of the risks were spelt out in the PDS and others such as financing risk 'famously weren't'.[102] An investor with Gunns underlined this same point:

> The PDS told investors about risks—showing investors that they may do a bit better or worse than forecasts suggested—BUT entirely failed to mention that you could lose 100% of your investment plus be pursued for a loan.[103]

5.65 Many growers struggled to come to terms with the prospect of having to repay a loan for something that was never delivered. One grower drew the following parallel:

> I liken it to buying a car from Holden with them providing the finance. You go to pick it up and they say 'Sorry, we don't have a car for you anymore and by the way, you now owe Ford the money for it![104]

5.66 Mr Michael Bryant, a former Timbercorp employee, understood why growers thought their loan was non-recourse, that their house would be safe, and the loan low risk. He informed the committee that all the presentations he saw conducted by business development managers and the senior executive conveyed the impression

97 Name withheld, *Submission 93*, p. [2].

98 *Proof Committee Hansard*, 6 August 2015, p. 6.

99 Grant and Karen Lillecrapp, *Submission 109*, p. 1.

100 *Confidential Submission 134*, p. [3].

101 *Supplementary Submission 186.1*, p. 2.

102 *Supplementary Submission 186.1*, p. 2.

103 *Confidential Submission 141*, p. 2.

104 Mr Scott Gannon and Ms Julie Gannon, *Submission 114*, p. 1.

that liability was limited. He explained that if you walked away from such a presentation:

> …as somebody who was new to the process, you would have believed that the only thing that was at risk was the investment asset that you thought you were investing in.[105]

5.67 Mr Craig Stranger, Managing Director of PAC Partners, understood that the managers of at least one leading MIS company were of the view that:

> …if the Company failed, then respective MIS investors would be fully protected. In hindsight this is clearly not the case.[106]

5.68 The liquidator for Timbercorp, KordaMentha, informed the committee that to avoid any doubt, Timbercorp Finance's rights under the loan agreements did not extend to the right to sell a borrower's home in the event they failed to make repayments and breach their obligations under the loan agreements.[107] But, as noted throughout this chapter, borrowers were still liable for any outstanding loan and some had sold, or feared they would have to sell, their home to meet their obligations.

5.69 Plainly, many growers who made submissions to the inquiry held the common view that their liability was limited to their lots—they signed a document that they understood was for a non-recourse loan.[108] Moreover, evidence from some financial advisers involved in selling the schemes indicated that even some of those actively recommending such investments did not know that the loans their clients were taking out to fund the investment exposed the clients to liabilities that went way beyond their investment.[109]

5.70 Many submitters, unaware that the loans were full recourse, maintained that they would not have taken out such a loan if they had known of the associated risks. For example, one couple indicated:

> We do not recall being scrutinised for such, & were therefore sold products that were way outside what would have normally been appropriate. We maintain these were sold as a non-recourse loan & were certainly not made aware of power of attorney clauses…these 2 points certainly would void our involvement.[110]

5.71 In addition, they stated:

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105 *Proof Committee Hansard*, 12 November 2014, p. 18.

106 *Submission 16*, p. 1.

107 KordaMentha, additional information on behalf of Timbercorp Finance, dated 4 December 2014, p. 3.

108 Neil White, *Proof Committee Hansard*, 12 November 2014, p. 39 and *Confidential Submission 124*, p. 2.

109 Mr Neil White, *Proof Committee Hansard*, 12 November 2014, pp. 38 and 40.

110 Name withheld, *Submission 61*, p. 1. See also name withheld, *Submission 121*, p. 1.

> We are a husband and wife who took on the GS recommendations of our NAVRA financial advisor, with the intention of creating an income stream 10 years down the track and not being reliant on government pensions in our senior years. We genuinely went with the advice with the clear understanding GS was a stand-alone loan against the GS asset only and, like hundreds of others in our ERA group case, we still maintain we have been misled.[111]

5.72 Likewise, one grower with Timbercorp stated clearly:

> When we purchased our investment in [the] Timbercorp scheme, our intention [was] it would be for our future retirement (I am 68) we were assured that the investment was its own security, and we would not be personally liable for the loan. In hindsight we would not [have] invested in Timbercorp if the representative had not assured us of this, although we will not lose our home we have to sell our holiday house which was to fund our retirement not to pay off a Timbercorp debt.[112]

Pressure selling

5.73 Not only were potential investors in agribusiness MIS presented with complex loan arrangements but many were urged to sign-up to such a commitment without time for proper consideration. As early as 2003, ASIC commented on the sales techniques used to sell agribusiness MIS. Importantly, at that time, ASIC's findings confirmed anecdotal information that:

> …some promoters do employ high-pressure sales tactics, encouraging investment in schemes using promotional material that focuses on the before- and after-tax savings. In many cases, accountants invited clients to these promotional seminars, but failed to give appropriate warnings to their clients about the suitability of the scheme for their individual circumstances.[113]

5.74 Despite these early concerns about the marketing of agribusiness MIS, the practices continued. Some submitters referred to the highly persuasive even 'hard sell' promotional techniques advisers and product issuers used to entice people into investing in the schemes.[114] For example, Mr Jayantha Anthony explained that he was 'given the information by a crooked Accountant and was signed the very next day with

111 Name withheld, *Submission 61*, p. 1. ERA Legal represented a certain group of investors who objected to the proposed Great Southern deed of settlement.

112 Name withheld, *Submission 32*, p. 1.

113 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 19.

114 See, for example, Mr David Huggins who noted that the entire process from completing an application to making an investment/application for finance and for funds to be drawn down took approximately 24 hours. *Submission 118*, pp. 4 and 7. *Confidential Submission 36*, p. [3].

no time to question as all were rushed'.[115] Another submitter indicated that he was sold the investments in MIS through aggressive sale tactics.[116]

5.75 The same approach applied to arrangements for loans, with one investor stating that she was 'pushed to sign documents quickly' or risk missing out 'on a great venture'.[117] Another investor informed the committee that they were told the investment was long term and would produce a moderate return: that there was no personal risk, everything was insured and their home 'would never be on the line'. Against this reassurance, their adviser emphasised that:

> …the current subscription was closing in the next week as it was nearly full, we were told it was quite urgent that we decide one way or another.[118]

5.76 This undue haste to have the investor sign up to the loans was a common story. Robert and Lynne Powell, aged 65, typified the many accounts provided to the committee:

> As uneducated investors we took our accountants advice and entered into a Loan agreement in June 2008. We were alone with the Timbercorp Representative when we signed up for the Loan and it was agreed and approved within two days.[119]

5.77 Another investor spoke of being contacted many times over the weeks following a promotional dinner, which was attended by his accountants/financial advisers and where Timbercorp representatives made a presentation. The investor and other members of his family were asked to invest and told that the contracts were already drawn up. He recalled:

> At that meeting the way to finance the investment was discussed and we were told Timbercorp Finance had already approved our loans, there was no need to bother looking for finance elsewhere. The documentation was all ready for us to sign, pre packed into a pretty coloured folder, we were not given copies of these contracts to review prior to signing, and we had no real alternate avenue of information to rely on as it was our financial advisors that were introducing us, prompting us to invest and then telling us what a great deal it was.[120]

5.78 Furthermore, and consistent with the experiences of many other investors, they were not told that their adviser was being paid a commission for the introductions and subsequent signing up of clients. The investors were also told that they 'needed to

115 *Submission 29*, p. 1.

116 Name withheld, *Submission 45*, p. 2. See also name withheld, *Submission 89*, p. [1]; *Confidential Submission 92*, p. [1]; *Confidential Submission 39*, p. 3.

117 *Confidential Submission 82*, p. [1].

118 Name withheld, *Submission 95*, p. [1].

119 *Submission 5*, p. 1.

120 Name withheld, *Submission 89*, p. [1].

make decisions quickly' as the schemes were being closed off in the coming weeks. They signed on the dotted line and started making their repayments.[121]

5.79 One couple equated the sales approach to actively chasing down the potential investor to 'complete the paperwork'. They referred to 'the extreme efforts' taken by the adviser to obtain clients' signatures, which, in their case, extended to having the paper work taxied to the investor at his place of work and to have him sign the paperwork 'on the bonnet of the taxi and have the taxi return to the adviser's office'. Based on their experience, there was an underlying sense of urgency to get them to sign the paperwork.[122] Moreover, some investors were urged to take out loans in the dying days of the schemes. For example, one submitter told the committee that:

> The final loan was approved when Timbercorp was facing liquidation. It is no wonder that it was approved within a day and without financials. In previous years it sometimes took Timbercorp weeks to approve loans. This time around, Timbercorp obviously needed money. Lots of it and fast.[123]

5.80 Mr Bryant, member of the Agriculture Growers Action Group and former officer with a number of agribusiness MIS including Great Southern and Timbercorp, explained that the people advising on the loan arrangements were not bank trained staff. He argued that it would follow that those signing up for the finance would not have received the level of advice and explanation that a bank trained officer could offer. He stated further that to the best of his knowledge:

> …there was really no oversight by the finance department at Timbercorp, which ran Timbercorp Finance, on how the representatives out in the field, the financial planners, were writing the loans.[124]

5.81 The evidence before the committee establishes a clear pattern of poor, and at times misleading advice, inadequate disclosure and pressure selling in an environment of over optimism and marketing exuberance. Trust in a reassuring adviser, who glossed over risks, coupled with aggressive selling techniques created an environment at odds with sound, considered decision-making.

5.82 Although in a quite different context, the evidence presented to this current inquiry regarding lending practices bears a striking resemblance to those detailed in earlier reports that have touched on borrowing to invest.[125] The accounts of hundreds

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121 Name withheld, *Submission 89*, p. [1].

122 *Confidential Submission 130*, p. [1].

123 *Confidential Submission 36*, p. [9].

124 *Proof Committee Hansard*, 12 November 2014, p. 16.

125 In its report on the performance of ASIC, the committee detailed the many cases of poor lending practices especially the targeting of vulnerable older people who were asset rich-income poor. It described practices such as brokers falsifying loan application forms. See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraphs 5.28–5.29.

and hundreds of people enticed into taking out loans that they could ill afford or for highly risky products cannot be ignored.

Committee view

5.83 The same irresponsible lending practices described in full in the committee's previous 2014 inquiry were similar to those associated with providing, or assisting to provide, finance to MIS investors—deliberate targeting of unsophisticated investors, falsifying information on loan applications, withholding information and documents, downplaying risks, placing undue pressure on potential growers to commit to a loan; overleveraging clients; and failing to undertake due diligence.[126]

5.84 The cases of shoddy lending practices cited in this report only hint at the extent of the practice and the number of people who saw themselves as victims of irresponsible, even predatory, lending. Clearly, many of these borrowers had no idea of the arrangements into which they were entering. As the schemes failed to perform to expectations, investors found themselves with mounting debt. In many cases, they were desperate to stem the losses and salvage whatever they could from the financial mess they found themselves in and, for some, to save their family home. They argued that had they been fully informed about the loan arrangements they would never have agreed to them.[127]

5.85 The committee draws attention to its 2014 findings, highlighting the fact that the practice of providing unsound and inappropriate advice to retail investors and, among other things, fabricating information in loan applications reflected badly on brokers, lenders and the regulator. It exposed the vulnerability of unwary and trusting borrowers, who were taken advantage of by unprincipled and self-interested brokers and lenders. Clearly, there is much scope for regulatory reform in this area of investment lending to retail investors. In chapter 11, the committee continues its consideration of the financing arrangements for investors in agribusiness MIS, with a focus on the banks as lenders.

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126 See, for example, Mr David Abraham, *Submission 64*; Mr Troy Lott, *Submission 101*, p. [1]; *Confidential Submission 59*; Confidential *Submission 156*, p. [6]. The author of *Confidential Submission 82* noted the urgency to sign and referred to sections of documents not being completed with assurances from her adviser that 'they would be handled at a later date and that they weren't important'.

127 Name withheld, *Submissions 44*, pp. 3–4.

Chapter 6

Retail investors

> We did not have the knowledge, skills or expertise to independently scrutinize the advice we were given. We trusted the professional conduct of the adviser with which we dealt. We invested on this basis.[1]

6.1 Many of the investors in agribusiness MIS saw themselves as unsophisticated investors—'just average hardworking Australians' trying to achieve financial security for the future. Some were single, some had young families while others were approaching or already in retirement. A number had never invested before and were looking for a stable and safe income stream.[2] In this chapter, the committee turns its attention to the behaviour of investors in an attempt to understand what motivated many of them to invest in an MIS without fully understanding the risks involved. It goes to matters such as the vulnerability of retail investors, trust and consumer protection.

Behavioural economics

6.2 The majority of growers who wrote to the committee described themselves as inexperienced even naïve investors seeking 'a good return' on their investment. For those approaching the end of their working lives, securing a reliable income for their future retirement was important.[3] Appreciating their limited understanding of financial matters, the investors sought professional advice. As one couple explained:

> It would be easy to dismiss us as greedy investors getting caught up in global events. However, the facts are that we are an ordinary, diligent family, with no history of prior investments of any sort (apart from our home), seeking advice from financial experts to help us support ourselves in retirement rather than relying on a pension.[4]

6.3 The growers who gave evidence to the committee assumed that they were correct in listening to, and taking advice from, professionals knowledgeable about, and experienced in, financial matters. They thought they could depend on this information.

6.4 Studies in behavioural economics highlight the fact that consumers' reliance on advice makes issues of trust and persuasion of central importance in the retail investment market. One study in particular found that generalised trust in advice can influence people's preparedness to invest in risky assets. Personal interactions that

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1 *Confidential Submission 134*, p. [1].

2 See chapter 3 and paragraphs 4.6–4.15.

3 Ms Barbara Gray, *Submission 54*, p. 1.

4 Mr Giles Lynes, *Submission 113*, p. [2].

elicit confidence may enable an advisor to persuade or influence a potential investor, merely by inducing positive emotions. Some consumers may be especially receptive to financial advice in the presence of perceived expertise.[5] Indeed, consumers may allow themselves to be influenced by advisers because they come across as 'likeable' and therefore 'trustworthy'.[6]

6.5 Consistent with such findings, ASIC's survey on retirement advice found that as most people lack the knowledge and expertise to assess financial advice, they use proxy measures instead. It gave the following example:

> …the client may be influenced by the adviser's confidence, approachability, friendliness or professional manner. Or they may simply view the adviser as the expert in what is generally a complex subject matter, and assume, as a result, that the advice and service is high quality.[7]

6.6 Importantly, however, the survey noted that these subjective evaluations rarely agree with the technical assessment of the quality of advice provided.[8] Likewise, the recently released report on Australia's financial system recognised the findings of behavioural economists showing that individuals are 'prone to making systematic errors in decisions that involve assessing risk and uncertainty', such as when making investment decisions.[9]

6.7 Put bluntly, Mr Jeff Morris, former financial adviser, stated that people invest in 'rubbish products which they themselves do not understand' because their adviser wears a nice suit, sounds plausible and has 'command of the jargon'.[10]

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5 European Union, *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective*, Final Report, November 2010, p. 6, http://ec.europa.eu/consumers/archive/strategy/docs/final_report_en.pdf (accessed 10 December 2014).

6 Financial Conduct Authority, *Applying behavioural economics at the Financial Conduct Authority*, Occasional Paper No.1, April 2013, p. 19, http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-1.pdf (4 December 2014).

7 ASIC, *Shadow shopping study of retirement advice*, Report 279, March 2012, paragraphs 202 and 203, https://dv8nx270cl59a.cloudfront.net/media/1343876/rep279-published-27-March-2012.pdf (accessed 12 December 2014).

8 ASIC, *Shadow shopping study of retirement advice*, Report 279, March 2012, paragraphs 202 and 203, https://dv8nx270cl59a.cloudfront.net/media/1343876/rep279-published-27-March-2012.pdf (accessed 12 December 2014).

9 *Financial System Inquiry, Final Report*, Commonwealth of Australia, November 2014, p. 215, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 10 December 2014).

10 *Proof Committee Hansard*, 12 November 2014, pp. 44–45.

Trust

6.8 The actions of many investors who made representations to the committee attest to the findings of behavioural economists that investors rely heavily on their advisers' suggestions and are highly susceptible to their recommendations.[11] For example, the committee heard numerous accounts of growers simply signing the form placed in front of them by their adviser.[12] They assumed that the adviser was working in their best interests and naively believed them. One such submitter stated:

> I trusted Holt Norman & Co with my family's future, but unbeknown to me these accountant/financial advisers were reaping huge commissions and bonuses while sinking me into enormous debt…
>
> To some degree, I accept responsibility for my own predicament. I definitely should have asked for clarification about the documents I was asked to sign. But my consultations with Bill Norman were often informal and we would make light of my inability to understand investment schemes. He would reassure me that investments were his speciality and that I did not need to worry about the details. I only needed to sign and return any paperwork that arrived in the mail.[13]

6.9 Many growers spoke of the confidence they gained from their adviser, who was able to convince them of the merit of the proposed investment. They were persuaded that the investment was secure: that the MIS was 'government endorsed, solid, long-term and supported agriculture in Australia'.[14] For example, a 'trusting client' of the Holt, Norman, Ashman Baker firm for nearly 30 years, spoke of the principals' nice demeanour and friendly chats' and believed there was no need to question their motives or practices. According to the client, however, the principals saw him as 'a soft mark, another sucker to sting'.[15] Likewise, another investor stated that he trusted 'a professional' but has been made 'to look like a fool'.[16]

6.10 The majority of investors who wrote to the committee, described themselves as conservative investors who opted for a 'low risk' profile.[17] A number made clear in their evidence that they had informed their adviser that they were not risk takers and wanted to ensure that their existing assets were well protected. For example, one investor informed the committee that:

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11 Mr Jeff Morris underlined the fact that clients are 'too trusting'. *Proof Committee Hansard*, 12 November 2014, p. 44.

12 Mr John McDonald and Mr Jeff Morris, *Proof Committee Hansard*, 12 November 2014, pp. 3 and 45.

13 *Confidential Submission 37*, p. 4.

14 *Confidential Submission 129*, p. 1. See name withheld *Submission 103*, p. 1.

15 Name withheld, *Submission 41*, pp. 3 and 5.

16 Shaun Ritchie, *Submission 159*, p. [1].

17 *Confidential Submission 37*, p. 13.

> We were at a point in our lives where we recognised our middle-income earning capacity was not going to be greatly increased in coming years as we brought up our young family and we wanted to find a low-risk way to make long-term investments that would secure our future. Our combined knowledge of finance was perfunctory and other than two tiny share market parcels…we had never been confident to invest in the share market.[18]

6.11 Frequently, investors told the committee of their expectations that advisers would put clients' interests first or at the very least give appropriate advice.[19] As one grower stated:

> I advised him that I did not want to be in high risk investments and that I had put my trust in him as I had no knowledge of these types of investments. I had a young family and needed to put their needs first and I would be putting my trust in his financial advice.[20]

6.12 Yet another spoke of being unaware that his adviser, with whom he thought he had a 'professional customer/client relationship' and held in a position of trust, could be involved in a situation best described as 'not morally right'.[21] Understandably, he argued that financial advisers should have been above reproach.[22] Mr Peter Mazzucato, an investor in Timbercorp, informed the committee that:

> The only product that was discussed was MIS and in particular investments with Timbercorp. I had never hear[d] of MIS schemes prior to this. I did not know that there was any risk in investing in these schemes and confess to being totally naïve about investments outside of buying a house.[23]

6.13 Mr Mazzucato told the committee that after a short discussion his financial planner convinced him that Timbercorp would be a good investment. He was told that it was government backed; would provide an income stream for 23 years; was absolutely safe with no risk at all; and that literally thousands of people had been investing in these products for years. Consequently, Mr Mazzucato was eager to get involved with the scheme and, as with so many other investors, concluded—'After all, what was there to lose?'[24]

6.14 According to the growers who gave evidence to the committee, the advice sounded legitimate. As one grower told the committee, 'yes we were at fault as well;

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18 *Confidential Submission 154*, pp. 1 and 5.

19 For example, see name withheld *Submission 78*; name withheld, *Submission 151*, pp. 1 and 2; name withheld *Submission 152*, p. 1.

20 Name withheld, *Submission 152.*

21 Name withheld, *Submission 41*, p. 3.

22 Name withheld, *Submission 41*, p. 3.

23 *Submission 40*, p. [1].

24 *Submission 40*, p. [1].

for trusting, for believing and for following the advice we received'.[25] The sense of betrayal by a trusted adviser was a dominant theme with another suggesting:

> We trusted this professional, unaware that he was acting as a sales representative for MIS recommending these investments motivated by his own financial plans rather than ours.[26]

6.15 Yet another told the committee that, at the age of 27, he tried to be sensible with his money and invest with the hope of purchasing his own house and ultimately, as a long term goal, of being a self-funded retiree. He was not sure of the best way to go about achieving his modest goal but assumed that 'a financial advisor and the laws governing them would help me invest my money in a smart and safe way'.[27] He was advised to invest in Great Southern grape vines 2007 and 2008, described by his adviser as a safe, government endorsed product with tax deductions, which, to the grower's mind, 'added to the security of the product'. [28] Another stated:

> The way it was presented we believed (perhaps naively) that not only would we then be certain of being self-funded in our retirement but we would also be investing in Australia.[29]

6.16 Many simply could not fathom how they ended up in such a predicament, especially when they thought they had taken necessary precautions. One couple spoke of the stress that the entire system had caused and feared it was here to stay, and 'all because we did the right thing—earned money honestly, invested after expert opinion was sought, paid our taxes, saved for self-funded retirement within the guidelines'.[30]

6.17 Mr Peter Jack, investor in Timbercorp, who was advised by both his financial adviser and accounting firm, stated:

> As the product was brought to us by our financial planner and then confirmed as a viable and legitimate product by our accountants we undertook to invest in Timbercorp with the opinion we had sought the right advice.[31]

6.18 Many investors assumed that they were receiving expert advice.[32] Voicing the experiences of many of the growers, one investor explained:

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25 Name withheld, *Submission 102*, p. [1] and name withheld, *Submission 4*, p. 1.

26 *Confidential Submission 134*, p. [3].

27 Name withheld, *Submission 70*, p. [1].

28 Name withheld, *Submission 70*, p. [1].

29 Name withheld, *Submission 71*, p. [1].

30 Ms Barbara Gray, *Submission 54*, p. [1].

31 *Submission 25*, p. 1.

32 Name withheld, *Submission 100*, p. 13. They stated, 'We did not have the skills to develop a business under a future financial strategy, hence we went to so called 'experts' for advice'.

> We did not have the knowledge, skills or expertise to independently scrutinize the advice we were given. We trusted the professional conduct of the adviser with which we dealt. We invested on this basis.[33]

6.19 In some cases, the trust had developed over many years especially with accountants who for years had been advising their clients on taxation. Mr John McDonald explained that, as a long standing client, he did not question the conduct of his adviser to the point where, in his own words, he would 'stupidly' not read documents thoroughly and would simply follow the directions "'Sign here; sign here". It's a done deal".[34] He explained:

> That trust developed over 20-odd years, and the habit of not reading documents properly before signing them built up over a similar period.[35]

6.20 Trust was also a critical element in following the advice to borrow to invest in the schemes.[36] One couple informed the committee that after receiving advice they went home and crunched some numbers. At that point, however, they started having concerns as to how the numbers would work if they took out another loan, in addition to the 2007 scheme. According to the investor:

> I started getting nervous. So back we went to Steve [adviser]. He truly was a great salesman. After showing him all my spreadsheets and concerns and explaining our situation we walked out of his office, having agreed to sign up to the 2008 scheme, our minds at rest that it would all be OK! To this day I have no idea how he persuaded us to do this. But he sounded so sure of himself and we trusted him completely as did many other of his clients who seemed astute and knowledgeable.[37]

6.21 A single, mature-aged woman informed the committee that she had received advice to invest in Timbercorp shares, $50,000 worth, financed through Timbercorp Finance. She said:

> Call me naïve, but I went to a financial planner as I expected that they would give me SOUND advice. By the time I signed the release form it was only days before the end of June 2008 and I had no awareness of the financial concerns.[38]

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33 *Confidential Submission 134*, p. [1].

34 *Proof Committee Hansard*, 12 November 2014, p. 3.

35 *Proof Committee Hansard*, 12 November 2014, p. 3.

36 Name withheld, *Submission 4*; name withheld, *Submission 78*; Mr Con Solakidis, *Submission 119,* p. [2]; *Confidential Submission 92,* p. [2]; and *Confidential Submission 134*, p. [2].

37 Name withheld, *Submission 56*, p. [3].

38 Name withheld, *Submission 73* (emphasis in original).

6.22 Along similar lines, another investor, who was unaware of the need to take out additional loans for management fees, stated simply that she 'stupidly trusted her adviser'.[39] Yet another grower stated:

> The thing I am most upset about is how I trusted the financial advisor, believed the Timbercorp documentation and advertising propaganda. It is clear the company was selling something they had no intention of delivering. If I borrowed money from a person selling a house and I did not get the house they would not get any money, this is the same. Simple.[40]

6.23 Ms Michelle Johnson told the committee that she quizzed her adviser about the security and soundness of her proposed investment scheme. Before agreeing to the suggested level of commitment, she spoke with her adviser about being a single mother and how she did not wish to risk her financial security. Ms Johnson explained further:

> I asked him outright if there was any risk of losing my home because I would not proceed if this could happen. He reassured me that this could not occur with his system. He stated his plan for me was long term investments for a tax effective income stream to be able to own my own home and be comfortable in my retirement, and that Timbercorp investments were endorsed by the ATO.[41]

6.24 Mr David Abraham stated simply that he took advice supported by the graphs his advisers produced, which showed 'the way tree harvesting would be able to repay interest and capital as well as give me a long term investment return'.[42] He referred to what appeared to be 'good financial advice'—charts, graphs, 'inspiring' seminars and 'hype' from Navra Financial Services and Great Southern.[43] One couple reported that their questions about the complex nature of the schemes and requests for more detail were greeted with reassurance that this was the adviser's 'field of expertise and that he would take care of things…'[44]

6.25 The same stories of investing in good faith on the understanding that the scheme would produce a good return in years to come were repeated with the following description just one of the many almost identical accounts:

> We were told it was a scheme completely backed by the government to support Australian agriculture. The whole point of the investment according to Steve [adviser], was that it was self-funding and that we should not expect high Forestry managed investment schemes returns or pie in the sky

39 *Confidential Submission 38*, p. 1.

40 Name withheld, *Submission 30*.

41 *Submission 139*, p. [1].

42 *Submission 64*, p. [1].

43 *Submission 64*, p. [1].

44 *Confidential Submission 134*, p. [3].

> profits. It was sold to us as a conservative pension fund of sorts to assist in retirement with only a very modest return.
>
> …
>
> We double checked with him what would happen if it all went belly up—we were told there was insurance to cover this, and there was no way we could lose on it. He re-iterated over and over that this was a safe, self-funding investment. We checked what we'd been told with Tony's boss who referred us to Steve, along with his extremely conservative accountant—same story.
>
> We honestly thought we were investing in a nice, safe investment, a product that was endorsed and supported by Australian government legislation, and that nothing could go wrong.[45]

6.26 Mr Shane Richards captured the experiences and sentiments of many growers who wrote to the committee when he stated:

> The plight of myself and many other borrower investors cannot be seen as just a group of dissatisfied people who took a gamble and lost, but a group of people who put their trust in what they were told and in the hands of the people charged with running the scheme…[46]

6.27 Clearly, investors formed the view that not only had advisers abused their position of trust but that the consumer protection regime had also failed them. As most of the small investors intimated, they did not have the knowledge, skills or expertise to scrutinize independently the advice they were given: they trusted the professional conduct of their adviser and invested on that basis.[47] One couple maintained those involved in selling the schemes:

> …have received government licenses that authorise them to make what the ignorant investor believes are expert and well researched, personalised plans but…the sad reality today is that the Australian consumer has more protection buying an item that costs just a few dollars than when they invest thousands, even millions through these so-called professionals. Something needs to be done and these unscrupulous accountants/financial planners need to be held accountable.[48]

Committee view

6.28 Evidence before the committee highlighted the vulnerability of retail investors and their high susceptibility to a persuasive financial adviser. It underscored the importance of consumer protection. Indeed, this report abounds with accounts of

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45 Name withheld, *Submission 56*, p. [1]. See also Scott and Julie Gannon, *Submission 114*.

46 *Submission 108*, p. [2].

47 Mr Alexander McShane, *Proof Committee Hansard*, 6 August 2015, p. 3. Also *Confidential Submission 134*, p. [1].

48 *Confidential Submission 36*, p. [1].

investors following the advice of their adviser because they truly believed that the adviser was a professional: an expert who would act in their clients' best interests irrespective of economic incentives that might influence that advice.

6.29 It should be kept in mind that the examples provided in this chapter represent only a sample of the submitters who referred to the trust that they placed in their adviser. The committee cannot put a figure on the number of people who have suffered because of the inappropriate product promotion of MIS and the accompanying poor financial advice. Some investors conceded that they were gullible or naïve and should have done more to ensure that they were investing wisely but, without doubt, trust played a major role in persuading them to invest in MIS. In the following part of this report, the committee looks at the conduct of the advisers, promoters, product producers and financiers and their motives in marketing and selling these products to retail investors.

Part II—Promoters and producers of MIS—advisers, product issuers, ratings experts, lenders and class action lawyers

The growers who took advice to invest in MIS were convinced of the soundness of their decisions and the integrity of those who marketed the schemes. As one grower stated it 'looked legitimate', asking 'After all, what was there to lose?' In this part of the report the committee examines the promotional aspects of MIS; the conduct of advisers who recommended the products; the developers and promoters who produced, managed and rated the schemes; the banks that lent to the investors and the lawyers who advised borrowers to cease repayments on their loans.

The committee considers weaknesses in the regulatory regime that left investors exposed to poor financial and legal advice.

Chapter 7

Financial advice and advisers

> We had no experience in this industry. However we trusted our accountants as we did not believe that they would be recommending an investment which was high risk and not in our best interests.[1]

7.1 Advisers occupy an influential position when it comes to the small investor making a financial decision. Australia's regulatory framework recognises the vulnerability of the retail investor to financial advice and places a heavy reliance on the conduct of advisers and on mandatory disclosure to protect retail investors from receiving bad advice.

7.2 As noted in the previous chapter, clients gave great weight to their advisers' recommendations and, even against their own inclinations, invested in inappropriate products that they did not fully understand. In this chapter, the committee looks at financial advisers and the regulatory framework governing their advice, in particular, its adequacy in protecting consumers from unsound advice.

Agribusiness and financial advice

7.3 Financial advice has a specific legal and regulatory meaning. Financial product advice means a recommendation or a statement of opinion, or a report of either of those things, that:

- is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or
- could reasonably be regarded as being intended to have such an influence.[2]

7.4 When most of the growers who made submissions invested in MIS, their financial advisers were required, under section 945A of the Corporations Act, to have a reasonable basis for advice. Until recently, this section, the so-called 'know your client' provisions, required advisers to recommend products in the light of their knowledge of clients' individual needs and circumstances.[3] In other words, the adviser must have been able to demonstrate that they complied with two central obligations—know their client and know their product. Licensees and their advisers were also required to ensure that the advice given to the client was appropriate.

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1 Mr Peter Tomasetti, *Submission 170*, p. 1.

2 *Corporations Act 2001*, s 766B.

3 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.39.

Deficiencies in advice

7.5 It is important to note that an awareness of shortcomings in the promotion and selling of agribusiness MIS date back to 2001 and 2002, when identifiable concerns about these schemes were surfacing. At that time, ASIC had formed the view that certain agricultural investment schemes often sold as tax driven schemes left 'much to be desired in terms of their marketing, promotion and operation'. It told the committee in 2001 that, as a percentage of the managed investments industry as a whole, the number of compliance problems in the agribusiness schemes area was high.[4]

7.6 In 2003, ASIC again expressed concerns about the quality of advice and disclosure in relation to the promotion of tax-effective mass-marketed schemes in the primary production managed investments sector. In particular, ASIC was aware of:

- the questionable commerciality of some of the schemes;
- at times, the poor quality and absence of adequate disclosure;
- occasional inappropriate or misleading advice; and
- payment of high commissions in excess of market norms for other retail investment schemes.[5]

7.7 Yet, over the next five years or so, interests in the agribusiness MIS continued to be promoted and sold, drawing in significant numbers of retail investors right up to the collapse of the major schemes. Evidence also shows that the problems known to exist in 2001 and 2003 persisted. The committee has provided many examples of advisers misleading their clients on the risks involved in investing in MIS or where they allowed, even encouraged, their clients to hold incorrect assumptions about the safety of the product and/or loan. Most of these advisers held an AFS licence or were an authorised representative of such a licensee.

Licensing requirements

7.8 Under the *Managed Investments Act 1998*, scheme promoters must hold a licence to operate the scheme and must obtain a separate authorisation in order to give advice relating to a scheme. The law allows a licensed dealer or adviser to issue a 'proper authority' to a representative, who is thereby authorised to act on behalf of the licensee. The licensed dealer has responsibility for ensuring that such representatives comply with the law and possess appropriate educational qualifications and experience.[6]

4 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.46.

5 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 4.

6 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.40.

7.9 Furthermore, the licence holder is obliged to notify ASIC of any proper authorities that they issue and is responsible for ensuring that such representatives meet ongoing training requirements. ASIC maintains a register of all proper authority holders.[7]

Statement of Advice (SOA)

7.10 If personal advice is given to a retail client, the provider (i.e. AFS licensee or authorised representative) must give the client a statement of advice (SOA). An SOA must set out the advice and the basis on which it was given.[8] It must also contain:

- the name and contact details of the provider of the advice;
- information about any remuneration (including commissions) or other benefits that the provider and related or associated persons or entities may receive (these amounts must be disclosed in dollars unless otherwise permitted by ASIC relief); and
- information about other interests, associations or relationships that might be expected to be or have been capable of influencing the advice.[9]

7.11 The SOA, which is to assist a client understand, and decide whether to rely on the advice they have been given, must be given to a client when financial product advice is provided.[10] The CPA informed the committee that although ASIC expects that an SOA is set out in a clear, concise and effective manner, they have become:

> …an unnecessarily long and complex compliance document used by the industry as part of the audit trail for protection from potential litigation. SOAs—in their current form, do little to enhance the consumer's understanding of the advice they are receiving. While an SOA must be tailored to the needs of each client, one option may be to explore what efficiencies could be achieved through industry consultation.[11]

7.12 It should be noted that a number of investors mentioned that at the time of signing up for the scheme they were not provided with, or in some cases not aware of, SOAs, financial service guides or general advice warnings.[12] For example, Mr Huggins told the committee that he was:

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7 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.41.

8 *Corporations Act 2001* (30 July 2004), s 947B and s 947C.

9 *Corporations Act 2001* (30 July 2004), s 947C.

10 *Corporations Act* 2001, s 946C sets down the critical time frames for providing a Statement of Advice. (30 July 2004).

11 *Submission 142*, p. [2].

12 See for example name withheld, *Submission 151*, p. 1; Mr Shaun Ritchie, *Submission 159*, p. [2]; name withheld, *Submission 162*, p. 1; *Confidential Submission 8*, p. [1].

> …aware of instances where no SOA was provided at all…the SOA was provided after the investment was made or the SOA was grossly deficient (sometimes being little more than a marketing style document that has apparently been produced by the *promoter* of the *scheme*).[13]

7.13 The committee has already mentioned the confusion and apparent lack of investor awareness about their loan arrangements. One such couple indicated that they were in possession of very few SOAs and certainly none that stipulated that loans were to be taken out in their name without their knowledge and 'funded by our margin lending dividend bank account'. They explained that their adviser was doing exactly that and cited an SOA for Citrus 2004 which outlined a loan for $80,000 but they were unaware that loans were taken out in their name for citrus, almond and olive or forestry schemes.[14]

7.14 Furthermore, investors were poorly equipped to appreciate the information contained in the disclosure documents. One couple who did receive a SOA and PDS explained:

> We were never encouraged to read them or seek independent advice. We were led to understand that we were purchasing lots of units of trees. There was little information provided regarding the nature of the investment. The language of the Statement of Advice described our purchases as 'LOTS' and 'Grovelots'.
>
> As such we believed we were investing in physical assets that would provide some financial relief in the event of failure of the business.[15]

7.15 In particular, they noted that in their SOA there was no mention in sections on project specific risks and revenue and financial risks of their exposure to debt should the business fail.[16]

Inappropriate advice

7.16 Many growers who wrote to the committee contended that they were the targets of white collar crime.[17] The words they commonly used to describe the financial advisers and accountants who enticed them to invest in the failed MIS included dishonest, unethical and self-serving.[18] One investor maintained that she needed protection from a shonky product that was sold by 'an unscrupulous, greedy financial planner'—'merely a product salesman' who:

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13 *Submission 118*, p. 7 (emphasis in original). See also Mr Shaun Ritchie, *Submission 159*, p. [2].

14 Name withheld, *Submission 100*, p. 2.

15 *Confidential Submission 134*, p. [1].

16 *Confidential Submission 134*, p. [1].

17 *Confidential Submission 37*, p. 1; *Submission 54*, p. [1].

18 Mr Giles Lynes, *Submission 113*, p. [2]; *Confidential Submission 37*, pp. 1 and 2; *Confidential Submission 15*, p. [2].

> …did not have my interests at heart. We need another system to protect consumers![19]

7.17 Another couple, who also saw themselves as victims of an unprincipled financial advisor, informed the committee that their adviser had 'a one size fits all' approach to his clients.[20] They suggested:

> We received inappropriate and misleading advice for our situation as retirees, being balanced investors seeking a modest income so we would not have to rely on a government pension.[21]

7.18 According to one grower, Timbercorp never hinted at any danger or risk to their investments. He went on to state that the only worrisome risks were fire, windstorm and hail which were covered by the yearly insurance payment. His adviser:

> …acknowledged all investments have risks but they were minimal and to give additional weight to her advice she said she was putting her money in as well.[22]

7.19 Similarly, another couple informed the committee that they enquired about the risks but were told if there were any issues the RE would change hands and their investment would be safe unless there was a long term drought, which made sense to them at that time.[23] Some investors were told that their investment was conservative and there was 'guaranteed income'.[24] Another couple informed the committee that their adviser had encouraged them to mortgage their freehold home and investment properties and to use the funds to invest in these tax deductible schemes.[25]

7.20 The overwhelming view among the growers who wrote to the committee was that the products should not have been offered and sold to them.[26]

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19 Name withheld, *Supplementary Submission 52.1*, p. [2].

20 Name withheld, *Submission 65*, p. 1.

21 Name withheld, *Submission 65*, p. 1. See also Mr Peter Mazzucato, who identified major flaws in the advice he received from his financial adviser. The adviser did not provide him with a cash flow analysis, arranged a loan that was way above Mr Mazzucato's ability to pay based upon his income at that time. Also, the financial planner did not tell Mr Mazzucato about the ongoing costs of the loan. *Submission 40*, p. [2].

22 *Confidential Submission 36*, p. [6].

23 Name withheld, *Submission 97*, p. [1].

24 *Confidential Submission 125*, p. [1].

25 *Confidential Submission 36*, p. [4].

26 *Confidential Submission 35*, pp. 1–2; *Confidential Submission 115*, p. 3; *Confidential Submission 128*, p. 1.

Inappropriate risk for investor profile

7.21 A number of submitters were unaware of the risky nature of the investment indicating that their adviser conveyed a very different impression.

7.22 One of the most concerning aspects of the advice was the disregard shown for the investor's risk profile and interests. Many suggested that the advice was inappropriate, unsound and contrary to their financial situation: that they were poorly advised and their adviser lacked duty of care.[27] They spoke of how their financial planner ignored their risk profile: that they were placed in a high risk investment when they required a low risk one. Mr Mazzucato informed the committee that his financial planner classified him as a 'sophisticated investor'. When he told his accountant of this fact, the accountant was shocked and advised Mr Mazzucato that to be deemed a sophisticated investor he needed assets of over $2.5 million and an income in excess of $250,000 per annum—both of which were far from the case at the time.[28] One man informed the committee that:

> My wife's risk profile was determined to be 'conservative' and yet our financial planners within the Navra Financial Services/Navra Group Pty Ltd inappropriately advised us to invest our funds in highly-geared, high risk investments on high interest rates even though my wife was not in a working capacity. We are not financial planners and therefore we trusted their advice.[29]

7.23 Overall, in their assessment the financial planning industry was one where:

> …hardworking Australians, everyday mums and dads, are being duded by predators, wolves dressed up as lambs, who prey on their innocence and lack of knowledge.[30]

7.24 One investor maintained that his adviser group should not have recommended and then 'deceptively' implied that the investments were suitable for his financial situation'.[31] Another investor spoke of being coached through the questionnaire 'until my profile matched the requirements for the investment'. She stated further:

> I was completely naïve to why this was necessary. I did not realise that she was protecting herself by me being seen to be compliant.[32]

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27 Name withheld, *Submission 100*, p. 10; Mr Tyson O'Shannassy, *Submission 158*, p. 4; *Confidential Submission 35; Confidential Submission 36*, p. [4]; *Confidential Submission* 79; Confidential *Submission 115*, p. 2.

28 *Submission 40*, p. [2].

29 Roderick and Andigone Aguilar, *Submission 67*, p. 1; *Confidential Submission 92*, p. [1].

30 *Confidential Submission 36*, p. [1].

31 *Confidential Submission 35*, p. [2].

32 *Confidential Submission 81.*

7.25 Another adviser actively discouraged a woman from putting money into superannuation. According to her confidential submission, the adviser informed her that the problems with superannuation, among other things, was that it was 'locked away'; she could not access it if needed; she did not have enough money to make it viable and further 'there was no guarantee to whom it would be paid when she died'.[33]

7.26 The committee has noted that many of those who wrote to the committee were not financially well-off with little to no investment experience. But even those who were high income earners were entitled to receive sound professional advice from their financial adviser. One such high-income earner acknowledged that he received a tax benefit from his MIS investments but now had accumulated a significant debt arising from the MIS investments. He stated that his adviser only ever suggested investing in MIS and never promoted other investments. According to this investor, he now has virtually no superannuation, no diversification in his investment portfolio; a huge MIS debt; and is struggling to pay rates, school fees and tax.[34]

7.27 There are many cases where the investor clearly did not understand the agreements they were entering and the adviser appeared to do nothing to disabuse clients of false impressions. Indeed, evidence presented throughout this report so far strongly suggests that some financial advisers actively fostered misconceptions. Five glaring examples of the misunderstandings allowed to go uncorrected were that:

- the schemes were government endorsed by the ATO and ASIC;
- the investment was sound, safe and would return long term benefits;
- the investor was actually purchasing a piece of land as per the loan agreement;
- the investment funds would be used to plant trees or crops; and
- the loan used to finance the investment was affordable, self-funding and non recourse.[35]

Poor advice in the extreme

7.28 The FPA held very strong views on the standard of advice that was provided to retail investors in MIS by some financial advisers. Firstly, it questioned the quality of advice provided by a representative who is limited to recommending only one product, such as the numerous references to accountants who were an authorised representative of an MIS. Secondly, the advice ignored the fundamentals of good financial advice, in particular the importance of diversification—'Do not put all your eggs in the one basket'. The FPA noted:

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33 *Confidential Supplementary Submission 156.1*, pp. [1]–[2]. Ms Naomi Halpern provides another such example, who, by the end of 2008, found herself in substantial debt but with only $11,000 in superannuation. *Proof Committee Hansard*, 12 November 2014, p. 1.

34 *Confidential Submission 128*, p. 1.

35 See, for example, *Submission 56*, pp. [1]–[2].

> Those financial planners or accountants who recommended that their clients invest a majority or 100 per cent of their assets into a forestry management investment scheme, particularly using leverage, would not be considered appropriate.[36]

7.29 According to a FPA survey completed in 2009, FPA members who advised on forestry and agribusiness managed investment schemes, recommended that their clients limit the maximum on the whole in those investments to 'around 10 per cent, with some having rules that capped it as low as two per cent'.[37] Mr Neil Kendall, Chair FPA, explained that a five to 10 per cent exposure would give anyone in the situation of a product failure 90 per cent of their portfolio intact.[38]

7.30 Another important principle concerned the 'judicious use of debt'. Mr Mark Rantall, CEO FPA, explained that debt 'can be your friend, but it can be your foe':

> When you borrow and the assets that you borrow against disappear, or their value drops…you need to be in a position to service that debt. Clearly in these instances…there was inappropriate screening of people's ability to pay and inappropriate people were put into these products—and were also leveraged up inappropriately.[39]

7.31 In his view, a responsible financial planner would have recommended capping both the MIS and the debt at a 'relatively low level'.[40]

Committee view

7.32 The investors who made submissions to the inquiry received advice that defies some of the most basic and fundamental tenets of sound investing. The advice failed to promote portfolio diversification; played down the value of building and protecting a superannuation nest egg; mismatched the product to the investor's risk profile (recommending high risk products to low risk profiles); and placed the adviser's own interests ahead of those of clients. In some cases, potential investors were advised to divert funds intended for superannuation; not to invest in property; and to overcommit including borrowing up to 90 per cent through a full recourse loan in a speculative venture without considering that the project may fail to deliver as promised.[41]

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36 Mr Mark Rantall, *Proof Committee Hansard*, 6 August 2015, p. 24.

37 Mr Mark Rantall, *Proof Committee Hansard*, 6 August 2015, p. 24.

38 *Proof Committee Hansard*, 6 August 2015, p. 25.

39 *Proof Committee Hansard*, 6 August 2015, p. 28.

40 *Proof Committee Hansard*, 6 August 2015, p. 28.

41 *Confidential Submission 79*, p. [1] and *Confidential Submission 130*, p. [1].

Commissions

7.33 During the period under the committee's consideration, investor protection required only that investors be fully informed of the fees and commissions that applied: that there was 'no prohibition against charging high commissions'. Even though the Corporations Act clearly stipulated that commissions must be disclosed, this area of corporate governance in 2001 still exhibited many transparency related concerns. ASIC told the committee in 2001 that out of 91 prospectus documents investigated by ASIC:

> …30% did not disclose the commissions payable or the percentage of commission payable.[42]

7.34 The matter of high fees and commissions, raises two areas of concern—the incentive for an adviser to recommend a product for personal reasons (better remuneration irrespective of the merits of a product); and the siphoning of funds away from the investment. In this chapter, the committee is concerned with the influence that commissions exerted over the quality of financial advice.

Early concerns about commissions as a perverse incentive

7.35 As early as 2001, ASIC had identified high up-front management fees and commissions as a major area of concern in agribusiness MIS.[43] Again in 2003, ASIC was aware of the payment of high commissions in excess of market norms for other retail investment schemes.[44] At that time, it undertook surveillance to determine whether there was a link between the receipt of high commissions by financial advisers and the provision of inappropriate or misleading advice to investors to buy into such schemes.[45] It found that:

> …there appears to be a correlation between primary production scheme promoters paying high commissions to advisers and those advisers providing inappropriate financial advice when they recommend those products to clients. In ASIC's view, this correlation indicates that there may be instances of a failure by advisers to manage conflicts of interest, where their personal interests in recommending a product supersede the client's need for good and appropriate advice.[46]

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42 Minority Report by Senator Shayne Murphy to the Senate Economics Committee, *Inquiry into mass marketed tax effective schemes and investor protection,* Final report, February 2002, paragraph 1.125.

43 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection,* Final Report, February 2002, paragraph 4.49.

44 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 4.

45 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 4.

46 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 17.

7.36 Commissions paid to advisers were generally around the 10 per cent figure.[47] Former Timbercorp officer, Mr Peterson, informed the committee that advisers who were writing a lot of business would seek higher commissions by implying that otherwise they would support another scheme. He described the situation as 'almost like a bidding war'.[48]

7.37 In 2008, the NFF also identified the potential for high commissions to provide undue incentive for planners to invest client dollars in such schemes.[49] Adviser Edge, an investment research house that specialised in agribusiness, raised concerns about MIS. In 2008, it suggested that adviser commissions were too high in both 'an absolute and relative sense'. In its view, 10 per cent commissions were among the highest in the financial planning industry, stating further that there were:

> …many financial advisers [who] do not have a strong knowledge of the agricultural sector, and hence there is a tendency for investment decisions to be based more heavily on the level of commissions, rather than the strength of the project.[50]

7.38 Adviser Edge submitted that closer regulation of the level of commissions and marketing fees to advisers would 'result in less bias towards investments paying high commissions'.[51]

7.39 Many investors, who wrote to the committee, referred to the commissions paid to advisers for selling MIS and were convinced that the practice was a factor underpinning poor advice. In the words of one couple, the promoters:

> …used smooth talking financial planners to sign up investors under the guise of giving a comprehensive, 'well thought out' financial plan and at the same time pocketing substantial commissions. These commissions were paid in advance despite many of the investments projected to be cashflow positive only after 10 years or so.[52]

7.40 Another indicated that:

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47 See for example, name withheld, *Submission 44*, p. 3; name withheld, *Submission 53*; Mr Bill Murrowood, *Submission 112*, p. 1; Grant and Karen Lillecrapp, *Submission 109*, p. [1].

48 *Proof Committee Hansard*, 12 November 2014, p. 27.

49 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014). The NFF indicated the MIS promoters were offering financial planners commissions of between 10 and 13 per cent.

50 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 13, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

51 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 13, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

52 *Confidential Submission 36*, p. [7].

> We were easy targets for smooth-talking advisors whose greed is contemptible. Holt Norman misrepresented the facts about our investments and neglected to mention they were benefitting from muti-tiered commissions and trailing bonuses, as rewards for pushing these products.[53]

7.41 Looking back, many investors can now plainly see that the advice they received was compromised by fees associated with the product, which eclipsed their adviser's requirement to act in their best interests.[54] Mr David Huggins, a lawyer representing his client who had invested in an MIS, contended that the high level of commissions paid by these schemes distorted the advisory process. In his assessment, the scheme promotors had formed the view that it was:

> …necessary for high levels of commissions to be paid so as to induce advisers to provide advice about them—the issue being that it was apparent to advisers that there was a high level of risk associated with these products and they needed to receive substantial commission payments to, in effect, compensate them for the risk that their clients would suffer loss as a result of investing in these *schemes* and blame their adviser for this event.[55]

7.42 Another investor indicated:

> In hindsight I find that the advice provided by my accountant was biased based on his vested interest which outweighed his requirement to act in my best interests. (Due to the heavily incentivised fees associated with the product).[56]

7.43 Mr Tom Ellison, financial analyst, observed that a financial planner selling a managed investment product has a much greater incentive to get a 12 per cent commission, particularly when the success or otherwise of the product would not become known for a number of years. Moreover, the product could be sold every year—'it was not just a one-off'.[57] Based on years of experience in the financial services industry, Mr Jeff Morris advised that the level of commission alone for agribusiness MIS should have 'sounded a note of caution about their bona fides'. Furthermore, he reasoned you could gauge how bad it was by the level of commission payable:[58]

> …the commission was there precisely to seduce the judgement of these experts.[59]

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53 *Confidential Submission 37*, p. 2.

54 Mr David Lorimer, *Submission 55*; name withheld, *Submission 100*, p. 9; and name withheld, *Submission 78*.

55 *Submission 118*, p. 6 (emphasis in original).

56 Mr David Lorimer, *Submission 55*.

57 *Proof Committee Hansard*, 4 August 2015, pp. 21 and 24.

58 *Proof Committee Hansard*, 12 November 2014, pp. 42 and 43.

59 *Proof Committee Hansard*, 12 November 2014, p. 42.

7.44 AgriWealth similarly noted that most of the individual investors in MIS forestry projects who had suffered financial hardship were retail investors and were often persuaded by the financial advisers to invest in the schemes. It observed:

> The financial advisers often had a conflict of interest in providing advice to retail investors in so far as they received commissions, sales incentives, etc from the promoters of those schemes. Those incentives were not always disclosed to the retail investors in an open and honest manner.
>
> Where MIS products continue to be offered to retail investors there needs to be tightening of regulation around the actions of financial advisers, financial planners, etc. Full and frank disclosures must be made by advisers to retail investors.[60]

7.45 Mr Michael Bryant reminded the committee also about the soft dollar payments, now outlawed, that were also used to entice advisers to sell products—races, grand finals, expensive dinners.[61]

7.46 The MIS illustrated clearly how the payment of commissions as remuneration for advisors providing financial advice could compromise that advice.

Recent legislation

7.47 The concern about financial advisers receiving commissions for their services has been well aired over recent years and the reforms intended to remove this type of incentive payment have been implemented. The FOFA reforms recognised that product commissions:

> …may encourage advisers to sell products rather than give unbiased advice that is focused on serving the interests of the clients. Financial advisers have potentially competing objectives of maximising revenue from product sales and providing professional advice that serves the client's interests.[62]

7.48 As such, FOFA imposed a ban on the receipt of remuneration that could reasonably be expected to influence the financial product advice given to retail clients.

7.49 Based on evidence presented during this inquiry, some witnesses expressed concerns about any proposed relaxation or watering down of these reforms. Indeed, some identified the need for additional reforms. For example, Industry Super Australia (ISA) was concerned about any possible amendments to the legislation that would result in 'the re-emergence of practices such as conflicted remuneration which were central to the mis-selling of forestry MIS such as Timbercorp'.[63]

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60 *Submission 138*, p. 2.

61 *Proof Committee Hansard*, 12 November 2014, p. 13.

62 Replacement Explanatory Memorandum, Corporations Amendment (Further of Financial Advice Measures) Bill 2011, paragraphs 2.3 and 3.27.

63 *Submission 136*, p. 3.

Committee view

7.50 The committee recognises that the FOFA reforms may well have remedied one of the most pernicious incentives underpinning poor financial advice—commissions. The evidence clearly highlights, however, the importance of ensuring that there are no loop holes in this legislation that would allow any form of incentive payments to creep back into the financial advice industry.

Recommendation 2

7.51 The committee recommends that ASIC be vigilant in monitoring the operation of the FOFA legislation and to advise government on any potential or actual weaknesses that would allow any form of incentive payments to creep back into the financial advice sector.

Holding financial advisers to account

7.52 Advisers were not at fault in accepting high commissions. They were, however, in breach of the Corporations law by not disclosing such information. Licensed financial advisers were required to disclose to their clients all commissions attached to the sale of particular financial products and hence any possible conflicts of interests.[64] A number of submitters maintained that their adviser did not disclose the substantial commission they were receiving, including trailing commissions.[65] For example, Mr Peter Mazzucato did not know that his adviser had obtained secret commissions to promote the Timbercorp investment scheme.[66] Likewise, Ray and Maree Wilde were certain that no mention had been made of the 10 per cent commission their adviser would receive. They noted that the Timbercorp documents refer to five per cent.[67]

7.53 This tendency to gloss over or to fail to disclose commission is consistent with the pattern of poor behaviour of some financial advisers that included, as chronicled in this report, downplaying risks, failing to disclose material facts about loan arrangements, allowing the perception to take hold that the products were government endorsed, high pressure selling, overly optimistic projections about the products performance, and ignoring the client's risk profile. The matter of holding financial advisers to account for providing unsound advice is covered in greater detail in the following chapter.

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64 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.39.

65 Name withheld, *Submission 45*, p. [1]; name withheld, *Submission 62*; *Submission 89*, p. [1]; name withheld, *Submission 94*, p. [2]; Mr Bill Murrowood, *Submission 112*; name withheld, *Submission 121*; *Confidential Submission 36*, p. [3]; *Confidential Submission 39*, p. 2; *Confidential Submissions 81*, 130, p. [1]; and *Confidential Submission 140*, p. 2.

66 *Submission 40*, p. [2].

67 *Submission 43*, p. 2.

Role of accountants

7.54 A number of people providing advice on MIS were accountants. For example, during the Great Southern proceedings, the court was told:

> Most, if not all, investors in Great Southern projects sought advice from an external accountant and/or a financial planner prior to investing. However, not all accountants held their own AFSL and often did not want to because of the additional compliance costs. By appointing external accountants as Authorised Representatives of GSS [Great Southern], these accountants were able to act under GSS's AFSL and were able to provide their clients with financial product advice without having to obtain their own AFSL.[68]

7.55 Accountants occupy a privileged position, especially with long-term clients, where often they have established a good relationship and have insight into their client's financial affairs. In this regard, one investor captured the sentiments of a great many of the investors who wrote to the committee when she stated:

> My then accountant was my trusted adviser at the time, having been my accountant for some years, and I regularly took his advice on business and taxation issues as I was involved in a family business.[69]

7.56 One submitter, however, drew attention to the blurring of responsibilities between the roles of an accountant and a financial adviser providing financial advice.[70] For example, a lawyer acting on his client's account alerted the committee to his concerns about the conduct of an accountant. For a number of years, his client had been using the services of an accounting firm. An employee of that firm had been appointed as an authorised representative of Rewards Projects Limited, which held an AFSL and was the RE for the Rewards Group Premium Timber Project 2009. According to the lawyer, it appeared that the employee used knowledge of his client's financial affairs—information gained as a result of acting as the client's accountant—and access to his client, in terms of providing advice about taxation related issues, as a means of marketing the investment to him. The pertinent issue being that the alleged tax effective nature of the investment was the primary means by which it and similar investments were marketed to clients. Relevantly, the lawyer noted that:

> …issues concerning the quality of financial advice are usually thought of in terms of advice provided by financial planners. However, in my experience, accountants had a substantial involvement in the marketing of agricultural managed investment schemes to clients. In this regard, I assume that the promoters of these schemes viewed accountants as being a useful distribution channel for their products because their alleged *tax effective*

68 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [73] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

69 Name withheld, *Submissions 151*, p. 2. See also name withheld, *Submission 152*, p. 1 and Mr Shaun Ritchie, *Submission 159*, p. [1].

70 Name withheld, *Submission 41*, p. 3 and Mr Tyson O'Shannassy, *Submission, 158*, p. 3.

> nature would be relevant to issues that accountants were already discussing with their clients.[71]

7.57 In the lawyer's view, the practice of accountants providing advice about MIS was 'generally improper', as 'accountants' knowledge of their clients' taxation affairs was used as a means to market *tax effective* investments to clients'.[72] Furthermore, the accountants were often authorised to provide advice by the scheme's promoter. In his opinion:

> …a real issue arises as to whether it is appropriate that a person can, in effect, be authorised by the promoter of a scheme to solely provide advice about that scheme (the issue being that the accountant is acting as little more than a *salesman* for a particular financial product rather than as a financial advisor). More generally (as was the case here), these types of arrangements can leave clients with limited options should they receive poor financial advice—the issue being that if the promoter fails the client will not be able to pursue the promoter by way of an external dispute resolution scheme such as the Financial Ombudsman Service (in these circumstances, the only remedy likely to be left to the client is to commence proceedings in a Court against the accountant which can be problematic for a number of reasons).[73]

7.58 Clearly, accountants were in a position to use knowledge of their client's financial affairs to offer unsolicited advice. For example, one investor informed the committee that the MIS investment was brought to his attention and recommended to him during an unrelated appointment for business taxation advice.[74] Another couple said that their adviser was t heir trusted accountant who had been looking after their business affairs for many years. They stated that they now know that their accountant was not giving advice but selling products from which he profited and were clearly unsuited for their financial situation.[75]

7.59 One investor spoke of his financial adviser's 'grossly conflicted role' as a Great Southern representative. He argued that the adviser's 'inside knowledge' of his affairs enabled the adviser, based on the tax returns he had provided, to present the investor to Great Southern Finance as credit-worthy.[76]

7.60 A number of investors named certain advisers who had recommended investing in a particular MIS. During the course of the inquiry, the committee provided ASIC with the names of those advisers. According to ASIC, although

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71 *Submission 118*, p. 2 (emphasis in original).

72 *Submission 118*, p. 6 (emphasis in original).

73 *Submission 118*, p. 6.

74 Name withheld, *Submission 120*, p. [1].

75 *Confidential Submission 156*, p. [5].

76 Name withheld, *Submission 44*, p. 3.

referred to as advisers, one business, an accounting firm, did not hold an AFS licence nor was it a corporate authorised representative. Two were authorised representatives of a few MIS but recorded as investors rather than advisers and another was an authorised representative of Timbercorp Securities Ltd and Rewards Projects Limited. ASIC's understanding was that:

> …all of the Timbercorp Securities Limited authorised representatives were qualified accountants and only authorised to provide general advice to investors.[77]

7.61 But, according to the investors, these individuals or accountants did provide personal advice and facilitated the investment into the MIS.

7.62 Concerned about the possible lack of a robust regulatory regime governing accountants giving financial advice, especially an accountant who was an authorised representative of an agribusiness MIS, the committee put specific questions to the Treasury, ATO and ASIC. Their responses clearly spelt out the obligations on accountants or tax agents providing financial advice.

7.63 It should be noted that since the introduction of the FOFA reforms, financial advisers and accountants providing personal advice must act in their client's best interest and prioritise the client's interest over their own. According to ASIC:

> These new requirements should reduce any possible conflicts of interests in circumstances where accountants have information about a client's tax position and are providing financial product advice. This is because the adviser must put the client's interests ahead of their own.[78]

7.64 The Tax Practitioners Board (TPB), which is responsible for regulating tax agent services, is aware that some tax agent services are provided in the context of the provision of financial advice. It informed the committee that any person/entity providing such advice for a fee or reward needs to be registered with the TPB as a tax agent or tax (financial) adviser. According to the TPB, all tax practitioners who are registered with the TPB must comply with obligations under the *Tax Agent Services Act 2009* (TASA), which among other things, includes a legislated Code of Professional Conduct. Under this code a tax practitioner must act lawfully in the best interests of their client.[79] TASA commenced on 1 March 2010.

7.65 Despite recent reforms, and in light of the numerous references to tax agents providing advice on agribusiness MIS and on borrowing to invest in such schemes, the committee has lingering concerns about the regulatory regime covering accountants/tax agents providing this advice.

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77 ASIC, confidential answer to written question on notice, No. 19, 2 October 2015.

78 ASIC, answer to written question on notice, No. 8, 2 October 2015.

79 Treasury, answer to written question on notice, No. 10, 8 October 2015.

7.66 In light of the evidence and the concerns expressed about possible conflicts of interest and blurring of responsibilities in situations where a tax agent provides financial advice, the committee believes that this area of financial advice or advice on borrowing should be reviewed. Clearly, there are important lessons to be learnt from the experiences of investors who acted on advice from their accountant or tax agent.

Recommendation 3

7.67 While noting the 1 July 2016 expiry of the 'accountants' exemption' under Regulation 7.1.29A of the Corporations Regulations 2001, the committee recommends that the Treasury look closely at the obligations on accountants or tax agents providing advice on investment in agribusiness MIS (or similar schemes). The intention would be to identify any gaps in the current regulatory regime (or the need to tighten-up or clarify regulations) to ensure retail investors are covered by the protections that exist under FOFA and that the level of regulatory oversight of tax agents or accountants providing advice on agribusiness MIS (or similar schemes) does not fall short of that applying to licensed financial advisers.

Conclusion

7.68 The committee has established that some advisers failed comprehensively in adhering to the requirements to know their client and the product they were recommending, and to have a reasonable basis for their advice. Evidence indicates that, in numerous cases, advisers and accountants withheld important information, particularly about the high risks involved; wilfully downplayed risks; and exaggerated the returns on investment. They put their own interests above those of their clients in giving poor advice, which resulted in their clients sustaining substantial financial losses. Such advisers seemed more intent on selling a product because of the attractive commissions they could earn rather than providing their client with appropriate advice.

7.69 The committee has referred to recent reforms, such as banning conflicted remuneration, that should help to lift the quality of financial advice. In the following chapter, the committee considers other consumer protection measures including the educational standards and qualifications of financial advisers and the overall culture in the financial advice industry.

Chapter 8

Education and culture

> …where poor conduct leads to significant losses for investors, while markets can recover, quite frequently individual investors do not and do not have the capacity to.[1]

8.1 In many ways, the problems associated with marketing and selling MIS have been addressed through reforms introduced since 2009. They include the FOFA legislation, which removed commissions and placed a heavy obligation on advisers to act in the best interests of their clients. There has also been a strong push for more professional and better trained and educated financial advisers.

8.2 In this chapter, the committee considers the importance of these reforms and, in light of the lessons to be drawn from the collapse of the high-profile MIS, whether any further measures are required to strengthen consumer protection. It looks at financial advisers and their qualifications, the overall culture that pervades the financial services industry and the banning of unscrupulous advisers. But firstly, the committee considers the investors themselves and how they can protect their own interests.

Financial literacy

8.3 Investors must take responsibility for the decisions they make. The committee has considered and made a number of recommendations designed to improve the reliability and adequacy of information provided to potential investors. Even so, the committee understands that investors need to have a certain level of financial literacy to make informed and considered investment decisions. CPA Australia noted that improving investors' financial literacy was integral to making better financial decisions. It stated:

> Without an appropriate level of financial literacy, an investor cannot be in a position to make an informed decision even if they are presented with simple advice and disclosure documents. We acknowledge the work of ASIC and the industry in this regard, and understand that the value and benefits of greater consumer understanding is a long term goal to be achieved.[2]

8.4 In this context, the committee's inquiry into rates on credit cards underscored the importance of having a financially literate population.[3] Evidence before that

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1 Mr Greg Tanzer, *Proof Committee Hansard*, Inquiry into the Scrutiny of Financial Advice, 7 July 2015, p. 24.

2 *Submission 142*, p. [3].

3 Senate Economics References Committee, *Interest rates and informed choice in the Australian credit card market*, December 2015, pp. 72–77.

inquiry recognised that consumers are pitched against the resources and ingenuity of people with the knowledge and wherewithal to outwit them. For example, Mr Paul Clithero, of *Money Magazine*, noted that the individual consumer has no power against the behavioural marketing skills of a huge institution. Agreeing with the need to improve financial literacy, Mr David Koch, Finance Editor, Seven Network, noted that people are lured into behaviour by 'millions of dollars of research on how to get around financial literacy'. In his view, financial literacy has 'got to get aggressive' to combat this asymmetry of influence and information.[4]

8.5 The same compelling evidence arguing for the need to lift the financial literacy standards of Australians was presented to the committee's inquiry into recent land banking schemes. In this case, property spruikers employing sophisticated marketing techniques (celebrity endorsements, pressure selling) convinced retail investors, who were prevented from fully understanding what was being offered, to invest in high risk inappropriate schemes.[5]

8.6 Evidence before this current inquiry into MIS presented example after example of growers enticed into investing into agribusiness MIS by assurances that the schemes were practically failsafe and, moreover, under erroneous impressions about the soundness of their loan arrangements. Further, investors signed incomplete forms, did not read carefully the disclosure documents or question their adviser. Some attended promotional marketing events followed by pressure selling of products, which they understood were government endorsed.

8.7 ASIC provided the committee with examples of its efforts to lift the standard of financial literacy in Australia. It also highlighted the difficulty of doing so. In this report, the committee has made recommendations that would place obligations on product issuers and research houses to act responsibly in the promotion and marketing of MIS. Much more, however, is required to equip the investor to protect their own interests. The committee recognises that improved financial literacy will go some way to help consumers make informed decisions.

Recommendation 4

8.8 The committee agrees with the view that financial literacy has 'got to get aggressive' and recommends that the Australian Government explore ways to lift standards. In particular, the government should consider the work of the Financial Literacy Board in this most important area of financial literacy to ensure it has adequate resources.

8.9 Drawing on the lessons to be learnt from the evidence on the need to improve financial literacy in Australia, the committee also recommends that the

4 *Proof Committee Hansard*, Senate Economics References Committee, Inquiry into matters relating to credit card interest rates, 27 August 2015, p. 43.

5 Senate Economics References Committee, *Scrutiny of Financial Advice, Part 1—Land banking: A ticking time bomb*, February 2016, chapters 3 and 4.

Australian Government in consultation with the states and territories review school curricula to ensure that courses on financial literacy are considered being made mandatory and designed to enable school leavers to manage their financial affairs wisely. The course content would include, among other things, understanding investment risk; appreciating concepts such as compound interest as friend and foe; having an awareness of what constitutes informed decision-making; being able to identify and resist hard sell techniques; and how to access information for consumers such as that found on ASIC's website. Financial literacy should be a standing item on the Council of Australian Governments' (COAG) agenda.

8.10 Chartered Accountants Australia and New Zealand (CA) also recognised the importance of financial literacy but appreciated that improved financial literacy was only a partial solution. It noted the complexity of agribusiness MIS and the imbalance in information between consumers and financial system participants, concluding that consumer education was limited. Furthermore, it stated:

> Similarly consumers' taking a greater responsibility for their investment decisions is beneficial but in the short term it is again limited. As a consequence there is greater responsibility and accountability required by the industry.[6]

8.11 While improved financial literacy is to be encouraged, it would only go part of the way to protecting consumers from investing unwittingly in risky products such as agribusiness MIS. One of the disturbing aspects of the accounts given by investors was the very fact that they realised their own limitations when it came to financial matters and sought out 'expert' advice. But, as mentioned above, consumers are pitched against the resources and ingenuity of people with the knowledge and wherewithal to outwit them and who, in some cases, hold themselves out as financial advisers: as professionals. Accordingly, financial advisers must be required to act in the best interests of their clients and be trained and qualified to do so competently.

Future of Financial Advice Reforms

8.12 In 2011, the parliament passed legislation, which took account of a variety of issues associated with corporate collapses, including Storm Financial and Opes Prime, and has direct relevance to the various MIS examined in this report. The implementation of the FOFA reform package was intended to improve the professionalism, quality and level of consumer trust and confidence in financial advice. It was to do so through enhanced standards that aligned the interests of the adviser with the client and by reducing conflicts of interest. In particular, it covered the provision of advice to retail clients of financial products, including agribusiness MIS.[7] The legislation implementing the reforms—the *Corporations Amendment (Future of Financial Advice) Act 2012* and the *Corporations Amendment (Further*

6 *Submission 143*, p. 4.

7 *Revised Explanatory Memorandum*, tabled 22 November.

Future of Financial Advice Measures) Act 2012—commenced on 1 July 2012 and became mandatory from 1 July 2013.

8.13 As noted in the previous chapter, recent reforms to Australia's financial advice regime have tackled one of the main drivers of poor advice—conflicted remuneration—and hence addressed a major factor that compromised the provision of advice in respect of MIS. It should be noted, however, that the 2014 final report into Australia's financial system recognised the need to better align the interests of financial firms with those of consumers by, among other things:

- industry raising standards of conduct and levels of professionalism to build confidence and trust in the financial system; and
- government amending the law to provide ASIC with an enhanced power to ban individuals, including officers and those involved in managing financial firms, from managing a financial firm, which would enhance adviser and management accountability.[8]

8.14 The evidence from this inquiry into MIS strongly suggested that when it came to the marketing of agribusiness MIS there was market failure on such a scale that regulatory intervention is needed to remedy the shortcomings.

Financial advisers—education and training

8.15 Improvement in the quality of financial advice through the requirement for higher educational standards has been under intense discussion. In June 2014, the committee made a number of recommendations including that:

- Financial advisers and planners be required to:
  - successfully pass a national examination developed and conducted by relevant industry associations before being able to give personal advice on Tier 1 products (which include securities, derivatives, managed investments and superannuation);[9]
  - hold minimum education standards of a relevant university degree, and three years' experience over a five year period; and
  - meet minimum continuing professional development requirements.[10]

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8 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 217, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

9 Tier 2 products are generally simpler and better understood than Tier 1. See ASIC, Regulatory Guide 146, Licensing: *Training of financial product advisers*, July 2012, http://download.asic.gov.au/media/1240766/rg146-published-26-september-2012.pdf (accessed 3 January 2016).

10 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 42, p. xxxi.

- A requirement for mandatory reference checking procedures in the financial advice/planning industry be introduced.
- A register of employee representatives providing personal advice on Tier 1 products be established.[11]
- The Corporations Act be amended to require:
  - that a person must not use the terms 'financial adviser', 'financial planner' or terms of like import, in relation to a financial services business or a financial service, unless the person is able under the licence regime to provide personal financial advice on designated financial products; and
  - financial advisers and financial planners to adhere to professional obligations by requiring them to be members of a regulator prescribed professional association.[12]
- The government consider whether section 913 of the *Corporations Act 2001* and section 37 of the *National Consumer Credit Protection Act 2009* should be amended to ensure that ASIC can take all relevant factors into account in making a licensing decision.[13]

8.16 The Financial System Inquiry (FSI) report also considered the quality of financial advice and similarly recommended raising industry standards and the competency of financial advice as well as introducing an enhanced register of advisers.[14] It referred to a number of high-profile cases where consumers had suffered significant detriment through receiving poor advice and ASIC studies that revealed issues with the quality of advice. For example, it cited ASIC's report on retirement advice, which found that only three per cent of SOA were labelled 'good', 39 per cent were 'poor' and the remaining 58 per cent 'adequate'. It found that:

> Although these cases and many of these studies occurred before the FOFA reforms to improve remuneration structures, this is not the only issue. Adviser competence has also been a factor in poor consumer outcomes. ASIC's review of advice on retail structured products found insufficient evidence of a reasonable basis for the advice in approximately half of the files.[15]

11 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendations 43 and 44, p. xxxi.

12 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 45, p. xxxii.

13 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 46, p. xxxii.

14 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, pp. 217 and 222, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

15 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 223, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

8.17 The Parliamentary Joint Committee on Corporations and Financial Services supported these findings and made a number of recommendations designed to raise the professional, ethical and educational standards of financial advisers.[16] Its findings add substantial weight to the call to implement without delay the recommendations intended to lift the quality of financial advice and for ASIC in particular to monitor and report on progress. ASIC's efforts should be augmented by the major industry bodies similarly assessing and reporting progress on the implementation of the reforms and their overall effectiveness.

Government response

8.18 The government responded positively to the FSI's recommendation to raise the competency of financial advice providers. It agreed:

> …to develop legislative amendments to raise the professional, ethical and educational standards of financial advisers by requiring advisers to hold a degree, pass an exam, undertake continuous professional development, subscribe to a code of ethics and undertake a professional year.[17]

8.19 An independent, industry-funded body will set the details of the new standards, which will be recognised in legislation.

8.20 The government also referred to the recently established register of financial advisers. It was the government's stated intention to amend the register to make clear whether an individual meets the new standards and whether relevant bans, disqualifications or code breaches apply to that individual. The term 'financial adviser' and 'financial planner' will be restricted to those listed on the register.[18]

8.21 In 2019, a statutory review is scheduled to consider whether the new regulatory framework had raised the professional standards of financial advisers and whether further changes are required. The government indicated that it would

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16 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry*, December 2014.

17 Australian Government, *Improving Australia's financial system, Government response to the Financial System*, p. 21, http://treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx (accessed 26 October 2015).

18 Australian Government, *Improving Australia's financial system, Government response to the Financial System*, p. 21, http://treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx (accessed 26 October 2015).

introduce legislation to raise the professional standards of financial advisers by mid-2016.[19]

8.22 On 3 December 2015, the government released exposure draft legislation designed to give effect to the government's undertakings to raise education, training and ethical standards for financial advisers, and called for submissions to be lodged by 4 January 2016.[20]

Culture

8.23 Much of the conduct detailed throughout this report, however, goes beyond competence. In many cases, the financial adviser was acting unethically—ignoring the client's risk profile, failing to disclose commissions or underplaying risks attached to the investment strategy. In some of the more egregious examples, submitters allege that their adviser falsified documents, withheld documents, and deliberately misled them. The FSI report raised similar concerns about the integrity of advisers. It drew attention to recent cases of poor financial services provision, which raised 'serious concerns with the culture of firms and their apparent lack of customer focus'. It noted that in 2011–12:

> …approximately 94 per cent of ASIC's banning orders involved significant integrity issues, where the alleged conduct would breach professional and ethical standards and/or the conduct provisions in the *Corporations Act 2001*. The remaining 6 per cent of cases involved competency issues.[21]

8.24 According to research undertaken by Roy Morgan, cited in the FSI report, 'only 28 per cent of participants gave financial planners "high" or "very high" ratings for ethics and honesty, and trust in bank managers was held by just 43 per cent of participants'. The FSI report also referred to an ASIC survey that found 'only 33 per cent of stakeholders agreed that financial firms operate with integrity'.[22]

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19 Australian Government, *Improving Australia's financial system, Government response to the Financial System*, p. 21, http://treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx (accessed 26 October 2015).

20 Department of the Treasury, 'Raising professional Standards of Financial Advisers', 3 December 2015, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Raising-professional-standards-of-financial-advisers (accessed 11 December 2015).

21 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 218, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

22 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 218, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

8.25 CA recognised that the combination of conflicted remuneration, tax deductibility and the single licensing regime could be considered drivers of poor advice. Even so, it suggested that with the removal of commission from the sales process of agriculture MIS there was a strong need 'to ensure there are the appropriate behaviours and culture in the advice of agriculture managed investment schemes'. CA referred to the FSI's finding that the industry more broadly needs to address the culture and leadership within its industry.[23]

8.26 In this regard, ASIC has made it clear that it is very concerned about culture and that this matter was 'front and centre these days'. It recognised that culture was 'a big driver of conduct in the financial industry'…that 'bad culture often leads to bad conduct', which inevitably may lead to poor outcomes for consumers. Mr Greg Medcraft, Chair of ASIC, explained:

> Given that there is a strong connection between poor culture and poor conduct, ASIC thinks culture is a major risk to investor trust and confidence, the cornerstone of our financial system, and to fair, orderly and transparent operation of our markets.[24]

8.27 The committee notes that subscribing to a code of ethics is one of the government's measures when developing legislative amendments to raise financial advisers' standards. In light of the evidence demonstrating that integrity issues were at the heart of some of the poor financial advice given to MIS investors, the committee highlights the importance of establishing such a robust code of ethics and that this measure warrants close and determined attention.

Recommendation 5

8.28 The committee recommends that the government give high priority to developing and implementing a code of ethics to which all financial advice providers must subscribe.

Banned advisers continue to operate in the industry—the 'phoenix phenomenon'

8.29 One way to send a strong message to the financial services industry about the government's commitment to ensuring that the industry adheres to high ethical standards is through removing people from the industry who bring the industry into disrepute. In its 2014 report on the performance of ASIC, the committee considered the banning of advisers and was particularly concerned about banned advisers or advisers who had been dismissed from their position for misbehaviour continuing to be involved in businesses providing financial advice. For example, Professor Dimity Kingsford Smith noted that even if a person is banned they may continue to be influential in a licensed firm as a director, officer or a significant shareholder. In her view:

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23 *Submission 143*, p. 4.

24 Senate Economics Legislation Committee, *Estimates Hansard*, 3 June 2015, p. 8.

> The tests for bans and director/officer disqualification are different, and consideration should be given to prohibiting a banned person acting as a director or officer. Similarly, consideration should be given to empowering ASIC to exclude from management a shareholder who is banned. ASIC should have express power to consider the fitness for a license of a firm where a banned person has a significant shareholding.[25]

8.30 In 2014, the committee asked ASIC whether any impediments existed to extending the ban on advisers to being a director of, or a person occupying a position of influence in, a financial services company. ASIC informed the committee that while it has powers to cancel an AFS licence or credit licence, or to ban a person from providing financial services or credit services, 'a missing element was a power to prevent a person from having a role in managing a financial services business or credit business'.[26] It explained that the law as currently drafted means that ASIC can have 'difficulty in removing these managing agents who do not themselves provide a financial service but are integral to the operation of a financial services business'. ASIC explained that it had:

> …seen instances where we cancel the AFS licence of an advisory business due to poor practices or other misconduct, but those responsible for managing the business move to another licensee's business, or apply for a new licence with new responsible managers.
>
> If such managers are not themselves directly providing financial services or credit services in that new role, ASIC may not be able to prevent them from continuing to operate in the industry, even where there were serious failings in the previous business.[27]

8.31 In its main submission to the committee's 2014 inquiry, ASIC recommended amending the law to provide ASIC with the power to ban a person from managing a financial service business or credit business. The FPA advised that it supported this recommendation, arguing that:

> If you have been banned as a financial planner there are usually very good reasons for it, and if you were then to be supervising and managing financial planners or a financial planning company we would see it as inappropriate—depending on the circumstances, of course. Obviously it would need to be a serious breach, not a minor breach.[28]

8.32 Having considered the evidence, the committee recommended in 2014 that:

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25 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 391.

26 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 391.

27 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 391.

28 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 391.

> …the government consider the banning provisions in the licence regimes with a view to ensuring that a banned person cannot be a director, manager or hold a position of influence in a company providing a financial service or credit business.[29]

8.33 In this regard the committee notes the observations contained in the FSI report. Consistent with the committee's 2014 findings, the FSI observed:

> ASIC can prevent a person from providing financial services, but cannot prevent them from managing a financial firm. Nor can ASIC remove individuals involved in managing a firm that may have a culture of non-compliance.[30]

8.34 The FSI report concluded by recommending stronger powers to ban individuals from management. It reasoned:

> An enhanced banning power should improve professional behaviour, management accountability and the culture of firms, by removing certain individuals from the industry and preventing them from managing a financial firm. This should also include individuals who are licence holders or authorised representatives, or managers of a credit licensee. It should prevent those operating under an Australian Financial Services Licence from moving to operate under a credit licence and vice versa.[31]

8.35 This matter once again came to the fore in this inquiry where evidence suggested that banned advisers were, under another guise, still operating in the financial services industry. A number of submitters strongly supported the findings of the FSI and its advocacy for enhanced banning powers to remove certain individuals from the industry.[32]

8.36 For example, some investors were concerned that their adviser, who had profited from the poor advice provided to clients, continued to practice. One submitter stated that the 'Phoenix Phenomenon' was 'well practiced amongst shonky advisers'. She explained that her adviser had sold his business pretending to retire on health problems but re-emerged as an employee in another financial services business.[33]

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29 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 47, p. 394.

30 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 218, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

31 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 220, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

32 Industry Super Australia, *Submission 136*, p. 4.

33 *Confidential Submission 92*.

8.37 Investors were particularly galled where their adviser, whom they considered had abused their position for personal gain, was found guilty of misconduct but promptly declared bankruptcy. The adviser, however, continued to maintain a life of apparent luxury and, furthermore, to practice in the financial services industry.[34] In a few cases, the financial advisers have been called to account for providing poor or inappropriate advice. One of the most notable advisers was Mr Peter Holt, who ASIC banned from providing financial services for three years after he failed to comply with numerous financial services laws.[35] For example, one couple noted that Mr Holt still enjoyed 'his multi-million dollar lifestyle with untouchable assets, while his clients suffer mental torture every day because of his financial misconduct…'[36] They observed further:

> It seems as if Holt's business can be temporarily wound up 'on paper' and suddenly reopened in a new version of itself, while victims are permanently shut-down, their lives put on hold, left to unravel in the aftermath of deceit.[37]

8.38 One grower was particularly distressed to know that her adviser, Mr Holt, was still working in the financial sector despite being banned.[38]

8.39 Mr Steve Navra was another individual whose name was mentioned in a number of submissions as an example of a disreputable adviser continuing to operate in the industry. For example, one investor stated:

> I have heard that Mr Navra (who provided the advice to my family, friends and I) has moved to Victoria and is again providing advice to unsuspecting investors. I am saddened to hear that this is the case and sincerely hope that his new clients do not have an experience like mine. I think a centralised register where potential clients/investors can check the credentials and history of an advisor would be a prudent mechanism.[39]

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34 *Confidential Submission 38*, p. 1.

35 Mr Holt was a director and authorised representative of Holt Norman & Co Pty Ltd and the Responsible Officer of Holt Norman & Co's AFS licence. ASIC cancelled the AFS licence of Holt Norman & Co on 19 September 2012. ASIC found that Mr Holt had failed: to have a reasonable basis for the advice he gave to retail clients; to meet his disclosure obligations to disclose the costs and benefits that may be lost in switching a client's superannuation; and to ensure the business maintained professional indemnity insurance. ASIC, 12-236MR, 'ASIC bans Victorian financial adviser for failing to comply with financial services laws', http://asic.gov.au/about-asic/media-centre/find-a-media-release/2012-releases/12-236mr-asic-bans-victorian-financial-adviser-for-failing-to-comply-with-financial-services-laws/ (accessed 17 August 2015).

36 *Confidential Submission 37*, p. 3; name withheld, *Submission 41*, p. 3.

37 *Confidential Submission 37*, p. 3.

38 Ms Michelle Johnson, *Submission 139*, p. [1].

39 Name withheld, *Submission 68*, p. [2].

8.40 Another investor also observed that Mr Navra was practicing 'wealth education' seminars in Melbourne.[40]

8.41 It should be noted that ASIC's analysis of Navra Group client files identified clients who may have received inappropriate advice. Accordingly, ASIC has instructed Navra Group to write to those clients informing them that the advice provided to them matched some ASIC indicators of inappropriate advice. Even so, ASIC has not taken any action against Mr Navra, who is not listed on ASIC's Financial Advisers' Register. The Navra Group went into liquidation in September 2011.[41]

8.42 Industry Super Australia referred to the FSI's finding that the existing banning powers were insufficient to stop 'particularly unscrupulous practitioners'. It suggested that FSI's recommendation to enhance banning powers, 'if implemented correctly, would have the potential to reduce consumer detriment in relation to forestry MIS and to ensure that consumers are adequately protected from poor product design and misleading advice'.[42]

8.43 The evidence produced during this inquiry into MIS adds even greater weight to the conclusions the committee had already reached in its report into the performance of ASIC and those of the FSI. In the committee's view, there can be no excuse for delaying taking stronger action against advisers engaging in egregious conduct and those banned from providing financial advice.

8.44 In its response to the FSI report, the government indicated its intention to develop legislation to allow ASIC to ban individuals from management within financial firms from operating in the industry. The committee welcomes this move but to underline the importance of removing opportunities for a banned financial adviser to resurface in the industry, the committee considers that the term 'management' may be too narrow. Thus, in light of the findings of this committee in two reports and of the FSI, the committee reinforces two recommendations it made in June 2014.[43]

Recommendation 6

8.45 The committee recommends that the government consider the banning provisions in the licence regimes with a view to ensuring that a banned person cannot be a director, manager or hold a position of influence in a company providing a financial service or credit business.

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40 Name withheld, *Submission 56*, p. [4]. The author of this submission noted: 'Steve Navra, after the first successful FOS claim against him immediately declared bankruptcy, relocated to Melbourne and is now practicing "wealth education" seminars down there. Why is this allowed to continue?'

41 ASIC, confidential answer to written question on notice, 2 October 2015.

42 *Submission 136*, p. 4.

43 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraphs 24.62 and 24.63.

Recommendation 7

8.46 The committee recommends that the government consider legislative amendments that would give ASIC the power to immediately suspend a financial adviser or planner, subject to the principles of natural justice, when ASIC suspects that the adviser or planner has engaged in egregious misconduct causing widespread harm to clients.

8.47 Some banned advisers or advisers with a poor track record and who are no longer registered, may continue to operate in the industry as 'wealth educators' but are no longer under the financial services regulatory regime. The committee considers this matter under the section dealing with general advice.

8.48 It is important to note that financial advisers are only part of the prevailing culture in the financial services industry. Product issuers and gatekeepers such as research houses, have obligations placed on them to act with integrity and ethically and should be held to account for their conduct. In the following chapter, the committee looks at product issuers.

Chapter 9

Product developers and promoters

> I feel embarrassed and ashamed at having put my hard earned money into products so unreliable and totally unsuitable for my circumstances that have delivered zero returns and cost me money. I have, and still continue to suffer stress and sleeplessness.[1]

9.1 Financial advisers had a prominent role in marketing and selling MIS but they were not the only agents. They relied on promotional material provided by the product manufacturers and were often part of a larger public relations campaign to attract investors into the schemes. While there can be no doubt that in many instances advisers may have misled their clients, sometimes inadvertently, sometimes deliberately, they themselves may not have understood or appreciated the pitfalls of the product they were recommending. Even though financial advisers should have known better, some of them fell under the spell of the promotional material produced by the product manufacturer and issuer.

9.2 Therefore, it should be recognised that there are various other parties in the industry that should also be held accountable for the promotion and marketing of financial products. The FPA drew attention to this fact in its submission to the committee's 2014 inquiry into the performance of ASIC:

> It is well established that, rather than all fault lying with the advice provider, there are multiple participants who offer products or services within the financial advice value chain, all of whom influence, directly or indirectly, consumers' decisions on financial matters. However, accountability of these participants to the end consumer is variable, limited and for some practically non-existent, which significantly restricts ASIC's ability to act…[2]

9.3 Thus, all stakeholders involved in selling agribusiness MIS contributed in some way to influencing a consumer's decision to invest in the product.[3] Indeed, the FPA attributed the large-scale losses associated with agribusiness MIS to 'inadequate leadership' and 'the non-existence of accountability' of those responsible for developing, providing research on, and marketing the schemes.[4]

9.4 In this chapter, the committee considers the disclosure obligations imposed on the producers and promoters of MIS and the extent to which they kept investors informed of their respective MIS. It looks not only at the comprehensiveness and

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1 Name withheld, *Submission 184*, p. 4.

2 *Submission 161*, p. 4.

3 *Submission 161*, p. 4.

4 Mr Mark Rantall, *Proof Committee Hansard*, 6 August 2015, p. 24.

comprehensibility of the disclosure documents but also of the conduct of the promoter and adviser when offering these products to the market. The committee also considers whether investors were appropriately and promptly informed of significant developments in the performance of the scheme.

Informed decision-making

9.5 As observed throughout this report, most of the growers who wrote to the committee described themselves as inexperienced and definitely not sophisticated investors. They claimed that they understood little about the complexities of MIS. For example, the common thread that seems to run through the experiences of many of the investors was that they were not 'savvy' business people but mostly 'working class people…trying to do their best to provide for our families'.[5]

Information asymmetry

9.6 Information asymmetries are a major factor that can prevent the market operating efficiently and have the potential to put retail investors at a disadvantage. Asymmetric information is when one party to a transaction has an inherently greater knowledge of the quality and risk profile of a product than the other side.[6] Those in possession of knowledge not available to the investor are able to use this imbalance for their own benefit. The information advantage, according to ASIC, 'gives opportunities to institutions and intermediaries to profit at the expense of investors and financial consumers'.[7] In this regard, the financial services' disclosure regime includes rules designed to:

- overcome the information asymmetry between industry participants and investors by requiring disclosure of information required to facilitate informed decisions by investors; and
- promote transparency in financial markets, and the efficient and appropriate pricing of assets and risks—for example, through continuous disclosure by companies of price-sensitive information.[8]

9.7 Product providers, distributors, advisers, and other gatekeepers of agribusiness MIS must then bear some responsibility for ensuring that consumers buying their product are fully informed about the risks associated with investing and borrowing to invest in their schemes.

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5 *Submission 68*, p. [3]. See chapter 6 for a thorough account of retail investors and their experience with MIS type schemes.

6 See, for example, Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 19.

7 *Submission 34*, paragraph 27.

8 *Submission 34*, paragraph 32.

Long standing concerns about disclosure

9.8 Long before the collapse of the major agribusiness MIS, some people in the industry were concerned that the risks associated with the schemes were not sufficiently disclosed. As early as 1993, the Law Reform Commission and the Companies and Securities Advisory Committee were issuing clear and unambiguous messages highlighting the importance of investors being well informed about the schemes in which they were intending to invest.[9] In particular, they noted that the regulatory framework for managed investment schemes had long recognised that:

> …the law can and should ensure that investors are given all the information they need to understand fully, and to judge for themselves, the level of investment risk associated with any scheme so they can choose, with full knowledge, the scheme that best suits their investment objectives.[10]

9.9 At that time, however, the Law Reform Commission and the Companies and Securities Advisory Committee, with great prescience, issued the following warning:

> As collective investment schemes, and the way in which they are marketed, become more complicated, it is more likely that schemes will be marketed to individuals who lack the financial sophistication to assess the risks involved in investing in them.[11]

9.10 They conceded that the law could not ensure that all intending investors would understand the nature of the scheme. They argued, however, that the law can, and should, impose rules to ensure that:

- the operator of the scheme gives investors all the information relevant to the assessment of risk that the operator has available to it; and
- information is presented in a clear and comprehensible way and is not misleading.[12]

Prospectuses and product disclosure statements

9.11 An MIS is deemed to be a financial product and hence various disclosure requirements regulate the process of giving personal advice recommending this

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9 The Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol 1, 1993, p. 9.

10 The Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol 1, 1993, p. 9.

11 The Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol 1, 1993, p. 10.

12 The Law Reform Commission, and the Companies and Securities Advisory Committee, Report *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol. 1, 1993, pp. 10–11.

product and offering or arranging its issue.[13] There are a number of key documents that form the basis of information that investors need in order to make informed decisions. The prospectus and product disclosure statement (PDS) are of central importance and legislation sets down the information they must contain.

Prospectuses

9.12 The function of a prospectus is to provide potential investors and advisers with sufficient information regarding the company's financial position and the nature of the security on offer so they can make an informed investment decision.[14] It should explain the merits and risks involved in participating in the scheme. This document must be prepared by, or on behalf of, the issuer or seller of a financial product. ASIC's Regulatory Guide made clear that the law requires an issuer to ensure that information contained in its prospectus is 'always current during the application period and to lodge a supplementary or replacement prospectus if it is not'.[15]

9.13 The product disclosure statement replaced the prospectus from March 2002 as a required instrument of disclosure for MIS.[16]

Product Disclosure Statement

9.14 In order to offer an agribusiness MIS to the market, the RE must publish a PDS. The PDS is designed to help consumers compare and make informed choices about financial products. When a financial adviser provides financial advice to a client that contains a recommendation to invest in an MIS, the adviser must give the client a PDS for that scheme.[17] Under these requirements, the adviser must do so at or before the time the adviser provides the advice; the information contained in a PDS must be up-to date at the time it is given and worded and presented in 'a clear, concise and effective manner'.[18]

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13 The definition of financial product includes an interest in a registered scheme; a legal or equitable right or interest in such an interest or an option to acquire, by way of issue, an interest or legal or equitable right as mentioned. For the more specific and detailed conditions governing disclosure see Chapter 7, Part 7.9, Division 2 of the *Corporations Act 2001*.

14 ASIC, Regulatory Guide 56, *Prospectuses*, (updated February 2000), RG 56, paragraph RG 125.

15 ASIC, Regulatory Guide 56, *Prospectuses*, (updated February 2000), RG 56, paragraph RG 56.18.

16 ASIC, answer to question on notice, No. 3, 2 October 2015.

17 *Corporations Act 2001*, s 1012A. Sections 1012A, 1012B and 1012C of the act establish the obligation to give a Product Disclosure Statement (PDS) when personal advice is given recommending a particular financial product; when an issue of, or an offer to issue, a financial product is made; or when an offer to sell a financial product is made.

18 *Corporations Act 2001*, ss 1012J and 1013C.

9.15 The Corporations Act recognises the matters that a PDS should take into account.[19] Section 1013D of the Corporations Act sets out the main requirements governing a PDS which, among other things, specifies that the PDS include the following information: any significant benefits to which a holder of the product will or may become entitled; any significant risks associated with holding the product and costs; amounts payable by a holder of the product after its acquisition; and the times at which those amounts will be payable. The PDS must include information about any other significant characteristics or features of the product or the rights, terms, conditions and obligations attaching to the product. In other words, it is required to contain any other information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product.[20]

9.16 ASIC explained that, with an unlisted product such as an agribusiness MIS, the product issuer, under the law, must lodge an 'in use' notice, which informs ASIC and others including investors that a PDS is in use and where they can obtain a copy of it.[21] Importantly, ASIC does not receive a copy of the PDS: it is not lodged with ASIC and ASIC does not approve a PDS' contents or 'stand behind the investment-worthiness of particular PDS' statements'.[22]

Disclosure of commissions and fees

9.17 Consistent with the requirement to disclose whether the product will or may generate a return to a holder of the product, the PDS must contain information about any commission, or other similar payments, that will or may affect the amount of such a return.[23] In 2003, ASIC provided the following guidance on fee disclosure in the PDS:

> Where the purpose of a fee includes the remuneration of advisers, this should also be indicated in the fee description.[24]

9.18 At that time, there was general recognition in the industry of the need for improved disclosure of adviser remuneration with ASIC advising that it was 'important in a good practice model to clearly disclose whether a particular fee includes commission'.[25] Also, ASIC was of the view that commissions and

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19 *Corporations Act 2001*, s 1013F.

20 *Corporations Act 2001*, ss 1013D and 1013E.

21 Mr Paul Eastment, *Proof Committee Hansard*, 14 October 2015, pp. 24–25.

22 Mr Greg Tanzer, *Proof Committee Hansard*, 14 October 2015, p. 24. Also see discussion in chapter 4 on ASIC and prospectus, paragraphs 4.38–4.43.

23 *Corporations Act 2001*, para 1013D(1)(e).

24 ASIC, Report 23, *A model for fee disclosure in product disclosure statements for investment products*, July 2003, paragraph 5.11.

25 ASIC, Report 23, *A model for fee disclosure in product disclosure statements for investment products*, July 2003, paragraph 3.9.

information on soft dollar arrangements needed to be spelt out clearly in the PDS. It advised that:

> …improved disclosure of adviser remuneration at all stages of the investment decision-making process (including the PDS) is an important consumer issue.[26]

9.19 The committee has already noted the high commissions advisers received for selling MIS. Some submitters suggested, however, that the commissions paid to advisers were not always fully disclosed.[27] Based on their recollection, they were unaware their financial planner was 'getting a substantial benefit in addition to the initial fee' with a reference to secret commissions being paid.[28] Evidence also indicated that the PDS failed to disclose to growers other material information about their investment in MIS.[29]

Misunderstandings

9.20 As highlighted in 1993, the law should ensure that investors are presented with all the information, in a clear and comprehensible way, required to make an informed decision. But, as noted throughout this report, many investors were confused, or simply misinformed, about important features of their scheme. For example, some investors were allowed, or even encouraged, to assume that the schemes were government backed—ATO and ASIC endorsed. The catalogue of misunderstandings about the nature or operation of MIS' investments included, in some cases, the requirement to pay up-front and ongoing maintenance fees. In particular, investors were under the false impression that their loans were structured in such a way that they were almost self-funding; that there was little risk of default with long term returns a certainty and liability limited to the actual investment (home not at risk). Few understood the implications of signing over power of attorney. Overall, many of the growers who made submissions to this inquiry thought the schemes were fail-safe: that they were unaware of the risks involved in the MIS. Some argued strongly that the PDS was misleading and had the document spelt out such risks, they would not have invested. In this regard, an investor stated that there was never any discussion of the risks, no PDSs provided until after the client had signed and all documentation was mailed.[30]

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26 ASIC, Report 23, *A model for fee disclosure in product disclosure statements for investment products*, July 2003, paragraphs 5.11 and 5.16.

27 See, for example, AgriWealth, *Submission 138*, p. 2.

28 See, for example, Mr Peter Mazzucato, *Submission 40*, p. [2].

29 Mr. Stefan Kaiser, *Submission 107*, p. 4.

30 Name withheld, *Submission 162.*

Ownership of tangible asset

9.21 Confusion about the structure and operation of the MIS went beyond the matters already identified in this report with grower after grower recalling their bewilderment at many aspects of the schemes' operation. For example, many were under the impression that their funds would go directly to their particular allotment. They thought that they would own a tangible asset—the trees or the actual harvest. One couple thought they were actually purchasing 'a piece of land as per the loan agreement…'[31] ASIC on the other hand explained that:

> …grower application money is (in most cases) diverted into the general working capital of the parent entity. The parent entity manages this money to meet expenses associated with all of its operations, including maintaining, cultivating and harvesting each scheme.[32]

9.22 Mr Tom Ellison, financial analyst specialising in Tasmanian listed companies, who bought two Gunns wood lots, stated that at one stage he did have a map but was yet to meet someone 'who actually invested in a scheme and who got to go and look at their own trees'. He noted:

> I know that, until 2006, Gunns and FEA [Forest Enterprises Australia] would pop people on a bus and take them up to the north-west and show them around, but I do not think it was a case of, 'Here are your trees.'[33]

9.23 Investors who came late to the schemes, felt particularly aggrieved about the apparent suddenness of the collapse which meant that their trees or crops were never planted. One woman explained that only a few months after investing, Timbercorp went into liquidation. It was inconceivable to her that she should have to repay with interest nearly $80,000 for something she had entered into just before its collapse—it did not seem 'fair or just'.[34]

9.24 The question of property rights became especially contentious during the liquidation of failed MIS. In its consideration of the establishment and operation of MIS, CAMAC observed that scheme members who have rights as lessees of property 'may have an expectation that their interests in the scheme are property interests that should have a favoured position in the winding up of a scheme'. It explained, particularly in reference to agricultural schemes:

> That expectation is not met under the present law where the lease can be disclaimed by a liquidator of the RE. To avoid disclaimer, member lessees

31 Name withheld, *Submission 56*, p. [2].

32 *Submission 34*, paragraph 52.

33 *Proof Committee Hansard*, 4 August 2015, p. 23.

34 Name withheld, *Submission 73*.

> would need to show that the prejudice to them is grossly out of proportion to the prejudice to the RE's creditors generally.[35]

9.25 CAMAC indicated that if the law remained unchanged, a question arises whether those who intend to become lessee investors should have the benefit of disclosure of the possible consequences of a liquidation of the scheme as it relates to the interests they intend to acquire in the scheme.[36] This confusing area of rights of investors, farmers who leased property to the RE and creditors is dealt with in chapter 15.

Projections and forecasts

9.26 The likely yield, which is a critically important consideration for any investor, was another aspect where growers failed to appreciate fully the information provided in disclosure documents. According to two researchers:

> The Product Disclosure Statements for plantation forestry do not give financial projections because ASIC policy strongly discourages them from doing so. However, they do give projections of physical yield, usually through the medium of an independent forester's report.[37]

9.27 During the early 2000s, however, some in the agribusiness industry were troubled by the yield projections in disclosure documents. They expressed concern that many agribusinesses were making 'excessively optimistic, if not misleading, projections of future product yields and marketability in their prospectuses'.[38] For example, in 2004, a number of submitters to the Senate Rural and Regional Affairs and Transport References Committee gave evidence indicating that the price estimates for future cropped plantation timber were either impossible to forecast or incorrect. One such witness put to the committee that 'forecasts contained in at least one prospectus for plantation investment indicated that realisable prices for wood were higher than the market was returning'.[39]

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35 Corporations and Markets Advisory Committee, *The establishment and operation of managed investment schemes*, Discussion paper, March 2014, p. 189.

36 Corporations and Markets Advisory Committee, *The establishment and operation of managed investment schemes*, Discussion paper, March 2014, p. 190.

37 Patrick Mackarness and B Malcolm, 'Public policy and managed investment schemes for hardwood plantations', School of Agriculture and Food Systems, The University of Melbourne, *Extension Farming Systems Journal*, volume 2, number 1, p. 105.

38 See, for example, Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final report, February 2002, paragraph 4.64.

39 Senate, Rural and Regional Affairs and Transport References Committee, *Australian forest plantations: A review of Plantations for Australia: The 2020 Vision*, September 2004, paragraphs 3.81–3.83.

9.28 Doubts about predicted yields of MIS projects did not abate especially as early plantations came 'on stream'.[40] Some submissions to the 2005/06 Plantation Forestry Taxation Review were concerned about the accuracy of the material which appeared in MIS prospectuses and cited 'some very ambitious yield forecasts'.[41] Around the same time, a study by the Rural Industries Research and Development Corporation also noted the poor quality of information available to investors. It observed:

> Arguably, the understandable attempts by ASIC to deal with the serious information problems of MIS have not been successful.[42]

9.29 In evidence to the committee, Mr Samuel Paton, principal of an agricultural consulting valuation firm, recalled that a PDS for a start-up MIS just out of Ballarat being developed by Environinvest stated that the scheme was going to produce 270 to 300 cubic metres per hectare of *E. globulus* from the site. Together with a forester, Mr Paton inspected the site, which, in his words, did not look 'too promising'. Further, Mr Paton informed the committee that based on the calculations of rainfall and soil structure, among other variables, the forester came up with a projected yield of 116 cubic metres per hectare. According to Mr Paton, '49 million dollars later, Environinvest went broke'.[43]

9.30 In the lead-up to the collapse of some MIS, concerns were still being voiced about a number of aspects of the schemes, including the information available to investors on performance. For example, in its 2008 submission to the non-forestry MIS review, the NFF raised significant doubts about the adequacy and independence of information available to potential investors in agricultural MIS.[44] In its view, an appropriate level of market accountability by promoters and managers of MIS projects had been lacking. While the NFF recognised that some MIS already provided detail on the long-term financial performance of the schemes, it formed the view that the

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40 Judith Ajani, 'Climate change policy distortions in the wood and food market', The Australian National University, Contributed paper to the Australian Agricultural and Resource Economics Society National Conference 2010, 8–12 February, p. 15, in *Submission 26.*

41 See, for example, submissions to the Review of taxation treatment of plantation forestry from Sam Paton & Associates Pty Ltd, http://archive.treasury.gov.au/documents/1000/PDF/042_Paton.PDF (accessed 1 May 2015) and Evan D. Shield, http://archive.treasury.gov.au/documents/1000/PDF/002_Evan_Shield_1&2.pdf (accessed 1 May 2015).

42 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries,* Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 48.

43 *Proof Committee Hansard*, 4 August 2015, pp. 1 and 4.

44 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 4, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014).

current system could not be relied on to deliver accurate and independent information commercially evaluated by industry experts.[45] The Victorian Farmers Federation was similarly concerned about that the lack of transparency surrounding MIS, which made it difficult to determine whether schemes were commercially viable and structured towards long-term sustainability.[46]

9.31 In 2008, Dr Judith Ajani observed that while planting continued apace, prospectus expectations of market opportunities for woodchips had not yet materialised.[47] ASIC noted in 2009 that a number of past projects operated by participants in the agribusiness managed investment scheme industry had failed to achieve their expected returns. It was of the view that:

> This information may be relevant to assist retail investors to decide whether or not they are prepared to invest in an agribusiness scheme. Accordingly, disclosure of historic yield information might reasonably be expected to have a material effect on the decision of a reasonable person to invest in an agribusiness scheme and required under the Corporations Act to be disclosed in PDSs. However, it appears that this information has not been disclosed in some agribusiness managed investment scheme PDSs.[48]

9.32 Evidence before the committee noted similar concerns about the reliability of projected yields. The Department of Agriculture referred to doubts being raised about the accuracy of the growth rate and yield forecasts contained in some forestry MIS.[49] Mr Peterson, a former Timbercorp officer, explained to the committee:

> …the most disappointing thing about Timbercorp is that it did not disclose to the growers, including senior management…exactly what would be the costs on horticulture, produce and timber lots if yields were not met and what was happening behind the scenes.[50]

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45 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 4, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014).

46 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. [1], http://archive.treasury.gov.au/documents/1423/PDF/Victorian_Farmers.pdf (accessed 23 November 2014).

47 Judith Ajani, *Managed investment schemes, tax deductibility and future plantation wood supply, Australia's Transition from Native Forests to Plantations: The Implications for Woodchips, Pulp mills, Tax Breaks and Climate Change*, ANU Press, nd (2008), http://press.anu.edu.au/agenda/015/03/mobile_devices/ch02s10.html (accessed 24 November 2014).

48 ASIC, *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia, August 2009, paragraph 209.

49 *Submission 135*, p. 8.

50 *Proof Committee Hansard*, 12 November 2014, p. 21.

9.33 He stated further that had Timbercorp been more honest about how the projects were performing, then certainly he and the many investors who lost badly would not have invested so heavily in the projects.[51] According to Mr Peterson, Timbercorp was very good at not disclosing full information to clients:

> In all the horticulture projects, you looked at a cash load to see whether you would go into it to see whether you would basically be able to meet your ongoing payments. What they did not do on an annual basis was give you an adjusted cash flow for your previous investment because if the growers saw that they would have been up in arms, saying: 'Hang on a minute! These yields are down, these costs are up; I'm never going to get into a positive cash flow position here.[52]

9.34 Mr Michael Hirst, Tasmanian farmer, similarly referred to numbers quoted in prospectuses, describing them as 'pure fudging of the figures'. With regard to tonnage, he told the committee that generally the yield was 'half of what they were quoting'.[53]

9.35 Importantly, a number of growers have taken their concerns about alleged defective PDSs to the courts. They maintained that the documents were deficient and because of this deficiency the arrangements they entered into should be nullified. While there is compelling evidence that information contained in PDSs on projected yields was optimistic, with some suggesting that it was misleading, the courts have, however, taken a different view. Two cases in particular are instructive—the first case dealt more broadly with claims of misleading PDSs, the second was concerned with the yields.

Court decisions

9.36 In 2011, in a case before the Supreme Court of Victoria, the plaintiff argued that Timbercorp Securities, in breach of its disclosure obligations under the Corporations Act, failed to disclose in its PDSs information about 'significant risks, or risks that might have had a material influence on the decision to invest'. In essence, the investors argued that the PDSs given to them contained false or misleading statements.[54]

9.37 In his judgment of September 2011, Justice Judd summarised the case pleaded by the growers who had invested in Timbercorp schemes. They claimed that:

- the RE, Timbercorp Securities, had failed to disclose information about risks it was required to disclose in compliance with its statutory obligations; and
- the Group business model involved risks associated with its financial structure that should have been disclosed to existing and potential scheme investors

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51 *Proof Committee Hansard*, 12 November 2014, p. 22.

52 *Proof Committee Hansard*, 12 November 2014, p. 18.

53 *Proof Committee Hansard*, 5 August 2015, p. 15.

54 Woodcroft-Brown v Timbercorp Securities Ltd [2013] VSCA 284 (10 October 2013) [6]

because the risks were significant or may have had a material influence on a decision to invest in a scheme.[55]

9.38 The plaintiff argued that he would not have invested in the schemes and would not have borrowed from Timbercorp Finance to do so if he had been informed of:

- the structural risk—that the Timbercorp Group might fail because of insufficient cash; or
- any of the adverse matters—ATO's proposal to change its position on the deductibility of up-front fees paid by investors; and the tightening of global credit markets.

9.39 The investor was seeking declaratory relief, damages and/or compensatory orders, including an order that he and the group members were not liable for repayment of the loans from Timbercorp Finance.

9.40 The court, however, was not persuaded and found, among other things, that the Timbercorp Group was not required to disclose the risks identified by the growers; that there had been no misleading or deceptive conduct; and, in any case, there had been no relevant reliance by the investor on the alleged non-disclosure or representations.[56]

9.41 This decision adversely affected former members of the schemes, who hoped to be released from obligations under loan agreements they had reached with Timbercorp.

9.42 In October 2013, the Court of Appeal of the Victorian Supreme Court handed down a decision confirming Justice Judd's 2011 decision that denied damages to investors in the failed Timbercorp schemes. It also declined to grant investors relief from having to pay any further instalments on loans that had been arranged through Timbercorp and used to pay for the investments.[57]

9.43 The second case, the Great Southern (GS) proceedings, also centred on alleged deficiencies in the PDS. The plaintiffs argued that GS had issued PDSs relating to the offer of interests in its MIS that were 'defective' by reason of the provisions contained in Part 7.9 of the Corporations Act, which deals with financial product disclosure, and as a result suffered loss and damage.[58] This misrepresentation

55 Woodcroft-Brown v Timbercorp Securities Limited (in liq) [2011] VSC 427 (1 September 2011) [24]–[26].

56 Woodcroft-Brown v Timbercorp Securities Limited (in liq) [2011] VSC 427 (1 September 2011).

57 Woodcroft-Brown v Timbercorp Securities Limited (in liq) [2011] VSCA 284 (10 October 2013).

58 Clarke v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (11 December 2014) [6].

case—the 2005 and 2006 Plantation Group Proceeding—concerned the target yield capability of 250m^3 of timber per hectare of woodlots referred to in the PDS issued on 8 March 2005.

9.44 In response to the plaintiffs' argument, the defendants contended that, when regard is had to the contents of the PDS, the misrepresentation case advanced in proceedings must fail: that the PDS, 'on its face, plainly does not represent what the plaintiffs plead that it represents'.[59]

9.45 Turning to the contents of the PDS, the court found:

> …its contents demonstrate that GSMAL [Great Southern Managers Australia Limited] did not promise, either expressly or by implication, that the plantations would produce an average of 250m^3 gross of timber per hectare of woodlots after approximately ten years of growth. On the contrary, the PDS contained many statements to the clear effect that the investment in the 2005 and 2006 Plantation Schemes was speculative, and that GSMAL and the directors did not make any forecasts or predictions as to future yields. Those statements are completely inconsistent with the implied promissory statement that the plaintiffs allege in paragraph 35(a).[60]

9.46 In essence, the court concluded that none of the PDS subject to the proceedings was 'defective'.

9.47 Bendigo and Adelaide Bank was also of the view that the relevant PDS were not flawed, pointing out that:

> Each PDS made it abundantly clear to investors that participation in the projects was considered to be speculative and prospective. Investments were of a medium- to long-term nature. The risks associated with plantation forestry were similar to any farming or agricultural venture. Investors were advised to read the PDS in its entirety and seek professional advice to ensure that an investment of that type was appropriate for their particular circumstances. The risks and speculative nature of the participation in the project were repeated many times throughout each PDS.[61]

9.48 In this context, the committee concludes that the disclosure requirements of the PDS cannot be considered in isolation. Retail investors make decisions in a complex environment where information and impressions are gleaned from numerous sources. The PDS is but one and, indeed, may not be the determining influence. For

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59 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [13] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

60 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [18] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

61 Bendigo and Adelaide Bank, response to *Submissions 52* et al, dated 24 December 2014, p. [4 and 5].

example, retail investors were expected to understand the significance of projected yields. In 2010, researchers referred to the practice of providing projections of yields and prices, rather than cash flow projections, in the disclosure documents to retail investors. They explained, however, that:

> Projections of yield, harvest costs, and harvest (produce) value, independently are based on a myriad of complex factors each of which is exacerbated by the long investment horizon.[62]

9.49 Consistent with generally accepted views, they argued that retail investors have limited ability to unravel the risks in such forecasts.[63]

Reconciling courts decisions with evidence

9.50 The committee has examined the testimony of growers in great detail trying to gauge the messages that advisers and product producers actually conveyed to potential investors in MIS. The courts have also grappled with the difficulty in determining the actual content and nature of the advice that product issuers and advisers offered their clients—whether it was deceptive, misleading, whether risks were appropriately identified and emphasised or important information omitted. They have to weigh up the written record with undocumented recollections. Although not dealing with agribusiness MIS, the courts have commented on this difficult task. For example, Justice Hulme had 'real doubts about the terms of the conversations concerning' investments where there was 'no reliable confirmatory documentary evidence'. Justice Hulme cited Chief Justice McLelland who in a judgement said:

> '[H]uman memory of what was said in a conversation is fallible for a variety of reasons, and ordinarily the degree of fallibility increases with the passage of time, particularly where disputes or litigation intervene, and the processes of memory are overlaid, often subconsciously, by perceptions or self-interest as well as conscious consideration of what should have been said or could have been said. All too often what is actually remembered is little more than an impression from which plausible details are then, again often subconsciously, constructed.'[64]

9.51 Justice Croft also referred to the fallibility of human memory and of the need to exercise care in evaluating the significance of memory, or the lack of it, with respect to events, conversations and documents experienced or encountered many

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62 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 11, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (9 December 2014).

63 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 11, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (9 December 2014).

64 Tomasetti v Brailey [2012] NSWCA 399 (11 December 2012) [34] [393] and Tomasetti v Brailey [2011] NSWSC 1446 (17 November 2011) [393].

years ago. He cited a statement of approach which appeared in the judgement of Justice Lewison:

> Witnesses, especially those who are emotional, who think that they are morally in the right, tend very easily and unconsciously to conjure up a legal right that did not exist. It is a truism, often used in accident cases, that with every day that passes the memory becomes fainter and the imagination becomes more active. For that reason a witness, however honest, rarely persuades a Judge that his present recollection is preferable to that which was taken down in writing immediately after the accident occurred. Therefore, contemporary documents are always of the utmost importance. And lastly, although the honest witness believes he heard or saw this or that, is it so improbable that it is on balance more likely that he was mistaken? On this point it is essential that the balance of probability is put correctly into the scales in weighing the credibility of a witness, and motive is one aspect of probability. All these problems compendiously are entailed when a Judge assesses the credibility of a witness; they are all part of one judicial process and in the process contemporary documents and admitted or incontrovertible facts and probabilities must play their proper part.[65]

9.52 The committee was similarly placed in attempting to reconcile the accounts of past conversations with advisers and scheme promoters with contemporaneous written documentation such as the PDS. While the written evidence told one story, many growers were recalling a very different version.

9.53 The committee has discussed at length the trust that clients placed in their financial advisers, even to the extent that some may have signed documents they did not fully read and did not comprehend. They looked to their adviser to interpret the information. Conversations between adviser and client, however, are not recorded and hence their contents cannot be verified.

9.54 Even so, it should be noted that the committee found the consistency of evidence produced from a range of different investors about their understanding of the risks identified with MIS cannot be discounted. It is persuaded that their accounts have validity. The committee contends that the written evidence, such as the PDSs relied on by the courts, does not capture the full breadth of advice that the investors received from the promoters and advisers: that PDSs do always convey the full story. Thus, even if disclosure documents complied with the regulations, investors may have received wrong messages or misinterpreted the information. In the committee's view, consideration must be given to the broader context in which advice is given.

65 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [60] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

Agribusiness PDS—scope for improvement

9.55 As mentioned above, matters such as yield projections contained in PDSs were based on a multitude of complex factors complicated further by the 'long investment horizon'. Thus, with their limited ability to unravel the risks in such forecasts, growers tended to rely on others to interpret the material for them.[66]

9.56 Industry Super Australia also noted that 'inadequate or unnecessarily complex disclosure documents have been a common theme in complaints regarding Forestry MIS'.[67] It suggested, however, that even where disclosure is of a high standard, it alone is not an adequate tool to protect consumers. It cited the findings of the FSI that 'many cases of financial firm failure include situations where consumers have failed to understand the risk/return trade-off involved in a product, even if disclosure and advice were compliant'.[68]

9.57 CA indicated that industry broadly recognised that there were deficiencies in the current disclosure regime and, because agribusiness MIS were complex, greater attention to the appropriate design of these products and their disclosure was required. It stated clearly that the industry needed to take 'greater responsibility and accountability in terms of both the advice provided and the products designed'. [69]

9.58 The committee also notes the conclusions reached by Mr Garry Bigmore QC and Mr Simon Rubenstein Barrister at the Victorian Bar, who, in a recent publication, acknowledged the practical difficulties for investors bringing claims for relief for defective PDSs, including an 'overly prescriptive, complex and poorly drafted liability regime in part 7.9 of the Corporations Act'. They wrote:

> The regime relies on and incorporates definitions within definitions and exceptions within exceptions. It is difficult for lawyers to get their heads around—let alone investors lacking in legal training.[70]

9.59 In their words, this part of the Corporations Act is 'a prime illustration of confusing legislative drafting'.[71]

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66 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', January 29, 2010, p. 11, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (9 December 2014).

67 *Submission 136*, p. 3.

68 *Submission 136*, p. 4.

69 *Submission 143*, pp. 3 and 4.

70 Garry T Bigmore QC and Simon Rubenstein, 'Rights of Investors in Failed or Insolvent Managed Investment Schemes', in Stewart J Maiden, (ed), *Insolvent Investments*, LexisNexis Butterworths, 2015, pp. 237–238.

71 Garry T Bigmore QC and Simon Rubenstein, 'Rights of Investors in Failed or Insolvent Managed Investment Schemes', in Stewart J Maiden, (ed), *Insolvent Investments*, LexisNexis Butterworths, 2015, p. 238.

9.60 In response to a question on the practical difficulties bringing claims for relief for defective PDSs, ASIC noted that the liability regime in part 7.9 sets out the consequences for failure to comply with the various obligations with respect to a PDS and its interaction with the consumer protection provisions in the ASIC Act. It agreed that the provisions are 'relatively complex and may be difficult to navigate'. ASIC also highlighted the challenge for investors having to wade through these documents and, based on its experience regulating retail financial markets, noted:

> …people often do not read mandated disclosure documents, inadequately understand or even misunderstand those documents, particularly where the financial product involved is complex and/or the document is lengthy. The difficulty for investors in establishing that they relied on information in a PDS and suffered loss or damage as a result of being given the PDS, is more closely aligned to issues arising from the limitations of disclosure in addressing market failure.[72]

9.61 ASIC acknowledged further that certain limitations mean that disclosure is not always sufficient for the task of 'arming investors and financial consumers with key information to guide decision making'.[73] It noted that the Timbercorp and Great Southern class actions failed because in each case it was found that:

- the impugned PDSs were not defective, in that they did not contain misleading statements or omit information that should have been disclosed; and
- the plaintiffs failed to establish that they relied on the PDSs, and consequently, that they suffered loss and damage because they were given the PDSs.[74]

9.62 In January 2012, to assist investors in agribusiness ventures, ASIC released an agribusiness MIS regulatory guide with five new disclosure benchmarks and five principles that apply to all agribusiness scheme prospectuses.[75] These benchmarks were designed to help retail investors understand the risks and rewards of the offer and to enable them to make a more informed decision. They include:

- more transparent fee structures;
- annual reporting to investors; and

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72 ASIC, answer to question on notice, No. 3, 2 October 2015, p. 28.

73 ASIC, answer to question on notice, No. 3, 2 October 2015, p. 28.

74 ASIC, answer to question on notice, No. 3, 2 October 2015, p. 27.

75 Government response, The House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees: Inquiry into the future of the Australian Forestry Industry*, June 2013, p. 12, http://www.agriculture.gov.au/SiteCollectionDocuments/about/obligations/reports-tabled-in-parliament/inquiry-into-the-future-of-the-australian-forestry-industry.pdf (accessed 22 September 2015).

- disclosure of engaged third parties and their qualifications.[76]

Context of information—oral advice, wealth seminars

9.63 The committee has already highlighted the importance of considering the context in which advice is provided when determining whether the investor was appropriately informed particularly of the risks associated with an investment. The committee has referred to financial advisers often interpreting or misinterpreting the contents of disclosure documents for the clients. In this regard, the FPA argued that product manufacturers should be accountable for information acquired and contained in their PDS. In its view, the failure occurred whereby the product manufacturer put inaccurate harvest figures in their product disclosure statements:

> The product manufacturer should have been aware of that, and should certainly have been correcting it in the future, but should have been looking at what was realistic. That information has then been used second hand and third hand further down and obviously from an incorrect basis.[77]

9.64 But such documents, as well as glossy brochures, are also presented during promotional or information seminars.

Promotional events

9.65 Product issuers must also be responsible for the way in which they present disclosure documents such as the PDS. The committee has mentioned the high pressure tactics used by some advisers to convince their clients to invest in an agribusiness MIS. But investors were often primed by managers and product promoters, as well as accountants and financial advisers, at information or marketing events.[78] A number of submitters referred to their advisers as salesmen, not financial advisers, who were not providing advice but merely selling a product not suited to their clients' needs and from which they profited. For example, one couple went along to one such investment session:

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76 Government response, The House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees: Inquiry into the future of the Australian Forestry Industry*, June 2013, p. 12, http://www.agriculture.gov.au/SiteCollectionDocuments/about/obligations/reports-tabled-in-parliament/inquiry-into-the-future-of-the-australian-forestry-industry.pdf (accessed 23 September 2015). See also, ASIC, Regulatory Guide 232, *Agribusiness managed investment schemes: Improving disclosure for retail investors*, January 2012, http://download.asic.gov.au/media/1246956/rg232.pdf (accessed 23 September 2015).

77 Mr Neil Kendall, *Proof Committee Hansard*, 6 August 2015, p. 27.

78 Robert and Lynne Powell, *Submission 5*; Mr Anthony Jayantha, *Submission 29*; name withheld, *Submission 89*, p. [1]; name withheld, *Submission 53*; name withheld, *Submission* 56; *Kevin and Cristina Lee*, *Submission 174*. See also, ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 19. One investor referred to 'inspiring seminars and "hype"', Mr David Abraham, *Submission 64*, p. [1].

> There was a seminar held at the Hilton Hotel in George Street around this time in early 2008 which was attended by hundreds of people. Once again there was a mixture of various people from all walks of life but this time the attendance was the largest we had seen. The audience was addressed by Steve Navra and other representatives from Great Southern all of whom were extremely positive towards the scheme and all of the great plans they had in place at that time.[79]

9.66 Many were persuaded to invest by slick and compelling sales tactics: by talk of the 'returns so beautifully outlined and promised in the prospectus'.[80] As noted earlier, a number of the growers referred to being reassured by reference to the ATO and ASIC's endorsement of the scheme.[81] As one grower explained:

> I was provided with many glossy brochures, and the forecast returns looked healthy plus the scheme was endorsed by the ATO with the tax credits which made my decision to sign up seem like a good idea. I was happy I was doing something positive with my money and taking charge of my future to look after my family so as I didn't have to rely on Government handouts during my retirement years.[82]

9.67 A wife described how her husband was invited to a seminar where he was urged to sign up for a guaranteed return and without any discussion of risk.[83] In greater detail, an investor recounted:

> For each of the two years during my investment, my financial adviser had an evening seminar attended by a director/manager from TC [Timbercorp]. At the last such seminar a TC director was questioned on the risk to their projects if the government stopped the MIS schemes. His reply was that they were lobbying to have this not implemented and there is no risk to existing projects.[84]

9.68 One investor, who considered herself an ordinary, everyday suburban mother, also referred to the pressure to sign up for a 'rock solid project', stating that:

> Timbercorp products were promoted and <u>highly marketed</u> during dinner presentations and group discussions with investors. The representatives

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79 Name withheld, *Submission 56*, p. [3]. See also Mr McShane who referred to brochures and of attending very professional and well conducted seminars, which looked 'fantastic'. He expounded on the beauty of the scheme and how well it worked. *Proof Committee Hansard*, 6 August 2015, p. 10.

80 Name withheld, *Submission 96*, p. [1].

81 See, for example, Mr Andrew Reibelt, *Submission 104*.

82 Mr Michael McLeod, *Submission 87*.

83 Name withheld, *Submission 162*.

84 *Confidential Submission 140*, p. 1.

> were at liberty to change and alter loan applications forms on the spot, without consulting with Timbercorp Finance.[85]

9.69 Yet another investor wrote of how investment managers organised flashy dinner get-togethers and well-polished seminars and materials that 'all promoted their Australian Tax Office approvals and low risk returns'.[86] They created a 'perception of security and a failsafe investment'.[87]

9.70 The sophisticated marketing techniques employed by marketing people well versed in the art of selling financial products exerted significant influence over inexperienced investors. The committee has also commented on the trust that investors placed in their financial advisers. Thus, when considering any regulatory change, it is imperative that the government take close account of the findings of behavioural economists and the evidence presented to this inquiry that:

- retail investors may have difficulty deciphering the information contained in the PDS and hence do not comprehend adequately the significance of the risks as presented (or disguised) in disclosure documents;
- small investors tend to place the utmost trust in their adviser's recommendations, they do not always read information contained in key documents such as prospectuses, PDSs and statements of advice, and rely on their adviser to interpret this material for them;
- despite statutory obligations, advisers and product issuers do not always act in the best interests of the clients and may deliberately withhold, conceal or downplay important information—indeed, in the case of financial advisers, some appeared to have conveyed false impressions (or allowed them to take hold): for example, that the schemes were government and ASIC approved and optimistic yields were achievable;
- key information contained in glossy brochures, prospectuses and PDSs, and sometimes cited or distributed during promotional seminars, may not always help investors understand the product and its risks and instead may serve to obscure not inform; and
- highly charged marketing events—seminars and dinners—may be ideal vehicles for product issuers to promote and sell their products but without appropriate consumer safeguards can work to disadvantage potential investors.

9.71 The committee stresses that the context in which advice is provided—sales techniques and trusted financial advisers—is a potent influence and should not be underestimated. Disclosure documents, such as PDS, must be considered in this

85 *Confidential Submission 92*, p. [2] (emphasis in original).

86 *Confidential Submission 36*, p. [4].

87 *Confidential Submission 36*, p. [4].

context, which further demonstrates why PDS must disclose, in a clear, concise and comprehensible way, all information required to enable an investor to make an informed decision. They must clearly spell out the risks associated with the investment.

9.72 The FSI report supported the need for mandated product disclosure. In its view, such disclosure was 'necessary to inform the market and to support issuers and consumers in setting out the terms of their contract'. The FSI saw, however, scope to provide issuers with more flexibility to communicate mandated disclosure to better engage and inform consumers.[88] It recommended:

> …a self-regulatory, flexible approach to improving communication of risk and fees, allowing tailoring for different classes of products and avoiding prescriptive regulation, which would involve higher compliance costs. Industry should build on existing measures to improve consumer understanding of risk by including risk measures for investment products; for example, simple and non-simple MISs, securities and structured products. Industry should also consider examples of risk measures used in Europe and Canada.[89]

9.73 From the investor's perspective, the disclosure of risk in many agribusiness disclosure documents was not presented in a clear and comprehensible way and definitely not in a way that would have alerted them to the risk accompanying the schemes. The range of misconceptions chronicled in this report attests to the inadequacy of PDS on agribusiness MIS and the advice that accompanied their presentation.

Conclusion

9.74 The inadequacy and complexity of MIS disclosure documents and accompanying advice has been of long-standing concern. Agribusiness MIS are complex products and difficult to understand.[90] Disclosure documents—prospectuses, PDS and SOA—proved inadequate in alerting consumers to the risks of investing in agribusiness MIS. The shortcomings in the disclosure statements together with unsound financial advice and slick promotional strategies created an environment unsuited to informed and considered decision-making.

9.75 Clearly, product manufacturers and issuers should be held accountable for the information contained in their promotional material and disclosure documents. Such

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88 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 214, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

89 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 216, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

90 See, for example, observations by the Financial Planners Association, *Submission 161*, p. 7 and quoted later in this report at chapter 14, paragraph 14.6.

information must be accurate and comprehensible to retail investors and relevant to their investment decision. The evidence underscores the importance of PDSs doing what they are intended to do—help consumers compare and make informed choices about financial products. There is no doubt that, as a consumer protection mechanism, disclosure documents have not always served retail investors well. While these documents could be clearer; easier to comprehend; and better designed to inform the investor of risk, the product issuer and financial adviser must take responsibility for ensuring that the promotion and marketing of the product facilitates informed decision making. Without doubt, evidence before the committee supports the contention that retail investors need robust consumer protection and the reliance on disclosure documents left growers exposed to risks they did not understand.

9.76 The committee is of the view that the time is ripe to examine once again the efficacy of PDSs when it comes to conveying information to retail investors and enabling them to make informed choices.

Recommendation 8

9.77 The committee recommends that, based on the agribusiness MIS experience, the government consult with industry on ways to improve the presentation of a product's risks in its respective PDS. The intention would be to strengthen the requirements governing the contents and presentation of information, particularly on risks associated with the product. This measure should not result in adding to the material in these documents. Indeed, it should work to further streamline the contents but at the same time focus on information that an investor requires to make an informed decision with particular attention given to risk.

9.78 With this objective in mind, the committee also recommends that the government consider expanding ASIC's powers to require additional content for PDSs for agribusiness MIS.

9.79 The committee recommends further that ASIC carefully examine the risk measures used in Europe and Canada mentioned by the FSI and prepare advice for government on the merits of introducing similar measures in Australia.

9.80 In conjunction with the above recommendation, the committee recommends that the government consider the risk measures used in Europe and Canada mentioned by the FSI to determine whether they provide a model that could be used for Australian PDSs.

9.81 In the following chapter, the committee continues its consideration of the manner in which product issuers promote and sell their products. Recognising the current weaknesses in the disclosure regime, the committee, in chapter 14, explores whether MIS should have been marketed to retail investors in the first place. The committee is primarily concerned with regulations governing the product being sold.

Chapter 10

General advice

> …it is the context of the advice which is more influential on many consumers than the [general advice] warning.[1]

10.1 Financial product advice is divided into two types: personal advice and general advice.[2] Personal advice is given in circumstances where the provider has, or should have, considered the person's objectives, financial situation and needs.[3] Only one aspect of the person's relevant circumstances needs to have been considered for the advice to be personal advice.[4]

10.2 General advice is advice that is not personal advice: it is a recommendation or opinion that does not consider a person's relevant circumstances.[5] ASIC makes the following distinction:

> General advice about a financial product will not be personal advice if you clarify with the client at the outset that you are giving general advice, and you do not, in fact, take into account the client's objectives, financial situation or needs.[6]

10.3 Advice that is likely to be general includes the material provided at investment seminars and in marketing brochures and when advertising a particular financial product or product range.[7]

10.4 In this chapter, the committee looks at general advice in the context of agribusiness MIS. It considers whether the regulatory regime around the marketing of this product to retail investors was sufficiently robust to protect such investors. The committee also examines the role and responsibilities of research houses and the independent experts who rated MIS.

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1 Financial Planning Association, *Submission 161*, p. 3.

2 *Corporations Act 2001*, s 766B(2).

3 *Corporations Act 2001*, ss 766B(3).

4 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—conduct and disclosure*, October 2013, paragraph RG 175.45.

5 *Corporations Act 2001*, ss 766B(4).

6 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG 244.43.

7 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—conduct and disclosure*, October 2013, p. 98.

Regulations regarding the provision of general advice

10.5 Providers are required to warn clients that general advice does not take into account a person's objectives, financial situation or needs: this warning is known as the 'general advice warning'.[8] For example, a PDS is general advice and should contain an explicit statement that it 'does not take into account the investment objectives, financial situation, or the particular needs of any potential investor'. In this regard, ASIC provides the following guidance:

> When you are giving general advice to a client, in addition to giving a general advice warning, it is good practice to take reasonable steps to ensure that the client understands upfront that they are getting general advice and not personal advice. You should take reasonable steps to ensure that the client understands that you have not taken into account their objectives, financial situation or needs in giving the general advice. This will avoid confusion and help the client to understand the nature of the advice they are getting.[9]

10.6 ASIC informed the committee, however, that despite the obligation to give a general advice warning;

> …there are still instances when clients do not properly understand the nature of the advice they are receiving. Slickly presented seminars with high pressure selling tactics are an example of this.[10]

10.7 Recent inquiries—notably the legislation committee's inquiry into the Corporations Amendment (Streamlining of Future Financial Advice) Bill 2014 and the FSI—have considered the distinction between general advice and personal advice and the extent to which consumers understand the difference. A particular question raised during the inquiries was whether the term 'general advice' conveys adequately the nature of, and obligations associated with, the provision of general advice.

10.8 The committee's inquiry into the Corporations Amendment (Streamlining of Future Financial Advice) Bill 2014 received submissions and testimony expressing concern that consumers were often not cognisant of the nature of general advice.[11] For example, Mr Mark Rantall, CEO of the FPA, noted that many consumers do not appreciate that general advice does not consider a person's relevant circumstances:

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8 *Corporations Act 2001*, s 949A.

9 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, RG 244.44, http://download.asic.gov.au/media/1247129/rg-244.pdf (accessed 20 August 2015).

10 ASIC, answer to questions on notice, No. 6, p. 16, 2 October 2015.

11 Senate Economics Legislation Committee, *Corporations Amendment (Streamlining of Future of Financial Advice Bill 2014 [Provisions]*, June 2014.

> As long as the differences between general advice and personal advice are insufficiently clear to consumers, general advice will be perceived as a less costly form of personal advice.[12]

10.9 Mr Alan Kirkland, CEO of CHOICE, took the view that it was unrealistic to expect all consumers to understand the differences in the regulation of general advice and personal advice:

> We depend on consumers to work out, 'That's general advice, so there is a lower bar and I should be much more cautious'…It is just not realistic to expect the consumer to understand that distinction between personal and general advice.[13]

10.10 Noting the concerns about the possible misuse or misunderstanding of the term general advice, the committee recommended in June 2014 that:

> …the government give consideration to the terminology used in the Explanatory Memorandum and legislation (for example, section 766B), such as information, general advice and personal advice, with a view to making the distinction between them much sharper and more applicable in a practical sense when it comes to allowing exemptions from conflicted remuneration.[14]

10.11 In its interim report, released in July 2014, the FSI noted the committee's recommendation about making the distinction between general advice and personal advice clearer to consumers. It stated further:

> One issue with general advice is whether it is properly labelled. Some submissions argue that some of the conduct regulated as general advice could more accurately be described as sales information, advertising or guidance. The aim of this relabelling would be to give consumers a clearer indication of what is involved.[15]

10.12 The FSI report called for submissions on the proposal to rename general advice as 'sales' or 'product information', and to mandate that the term 'advice' could only be used in relation to personal advice.[16]

10.13 In the second round of submissions to the FSI, most stakeholders agreed that the term general advice was often confusing to consumers but there was no consensus on the term that should be used instead of general advice. The Australian Bankers'

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12 *Committee Hansard*, 22 May 2014, p. 19.

13 *Committee Hansard*, 22 May 2014, p. 17.

14 Senate Economics Legislation Committee, *Corporations Amendment (Streamlining of Future of Financial Advice Bill 2014 [Provisions]*, June 2014, p. 77.

15 Australian Government, Financial System Inquiry, *Interim Report*, July 2014, p. 3-73.

16 Australian Government, Financial System Inquiry, *Interim Report*, July 2014, p. 3-74.

Association stated that the industry 'acknowledges that general advice is not widely understood to be financial advice by consumers'.[17]

10.14 The FPA, which has consistently argued that the regulation of general advice was insufficient, suggested that the term 'general advice' should be replaced with 'product sales', 'general information', 'financial product information' or another term which clarifies the distinction between product sales and financial advice. In its second-round submission to the FSI, the FPA wrote:

> Framing general advice as financial advice plays into the behavioural aspects of financial decision-making by giving the impression that the advice has a reasonable basis or is appropriate for the client, and thereby exposes retail investors to decisions made under uncertainty about the regulatory framework for that advice.
>
> As with many other problems in the Australian financial system, our reliance on a disclosure-based regulatory approach has contributed to this confusion. While a general advice warning is required to be issued when providing general advice, it is the context of the advice which is more influential on many consumers than the warning.[18]

10.15 In the FPA's view, financial products, particularly complex financial products such as interests in MIS, should 'not be promoted or sold in circumstances where retail clients may reasonably believe that they are being offered advice that takes into account their personal circumstances'. The FPA also suggested that 'financial products should not be promoted or sold in circumstances where the consumer protection framework that applies to the individual is ambiguous'.[19] In its final report, released in November 2014, the FSI noted:

> …consumers may misinterpret or excessively rely on guidance, advertising, and promotional and sales material when it is described as 'general advice'. The use of the word 'advice' may cause consumers to believe the information is tailored to their needs. Behavioural economics literature and ASIC's financial literacy and consumer research suggests that terminology affects consumer understanding and perceptions.[20]

10.16 While recommending that general advice be renamed, the FSI's final report did not suggest a particular term to replace general advice: instead, it recommended a more appropriate term be chosen through consumer testing.[21] It considered that the

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17 Australian Bankers' Association, *Response to Interim Report*, Submission to the Financial System Inquiry, August 2014, pp. 55 and 58, http://fsi.gov.au/files/2014/08/Australian_Bankers_Association_2.pdf (accessed 10 July 2015).

18 *Submission 161*, p. 3.

19 *Submission 161*, p. 3.

20 Australian Government, Financial System Inquiry, *Final Report*, November 2014, p. 271.

21 Australian Government, Financial System Inquiry, *Final Report*, November 2014, Recommendation 40, pp. 271–272.

benefits to consumers from the clearer distinction between general advice and personal advice would outweigh the costs of consumer testing and the costs of updating existing disclosure documents.

10.17 In its response to the FSI report, the government agreed to rename 'general advice' to improve consumer understanding. It noted that it would consult with a wide range of stakeholders and conduct consumer testing before finalising the new term.[22]

10.18 The committee welcomes the government's undertaking to replace the term 'general advice' with one that clarifies the distinction between product sales and financial advice. It is not convinced, however, that renaming the term in and of itself provides adequate consumer protection particularly in circumstances where the product producer uses seminars and dinners to promote the product. The committee heard numerous accounts of growers, who attended seminars or promotional dinners, being encouraged to sign up to invest in agribusiness MIS.[23] It has highlighted the role that these investment seminars had in influencing investors and is particularly concerned about the way in which scheme promoters used high pressure or hard selling techniques during so called public 'information' or 'educational' sessions. This advice would be classified as general advice. Industry Super Australia drew attention to the risk stemming from the use of general advice to push complex products such as forestry MIS.[24]

10.19 The committee takes this opportunity to cite similar concerns about general advice given during investment seminars or 'wealth creation' sessions by property spruikers detailed in the committee's report on land banking.[25]

10.20 In this highly charged environment around information or promotional events, there should be clear obligations on the promoters engaging in this type of marketing to ensure that potential investors are fully aware of the risks carried by the product they are promoting. Investors must have access to full and accurate information about the product and be discouraged from signing up before they have the opportunity to seek independent financial advice—that is receiving personal advice. In this respect, however, the committee heard of occasions where the financial adviser was very much part of the promotional team.[26]

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22 Australian Government, *Improving Australia's financial system, Government response to the Financial System*, p. 22, http://treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx (accessed 26 October 2015).

23 See paragraphs 5.65, 5.72, 5.76 and 9.65–9.70.

24 *Submission 136*, p. 3.

25 Senate Economics References Committee, *Scrutiny of Financial Advice, Part 1—land banking*: *a ticking time bomb*, February 2016, paragraphs 3.53–3.55 and 8.80–8.90.

26 See paragraph 9.65, which noted Mr Steve Navra's participation at seminars promoting an agribusiness MIS.

Recommendation 9

10.21 The committee recommends that the government consider not only renaming general advice but strengthening the consumer protection safeguards around investment or product sales information presented during promotional events.

Recommendation 10

10.22 The committee recommends that ASIC strengthen the language used in its regulatory guides dealing with general advice. This would include changing 'should' to 'must' in the following example:

> **You <u>must</u> take reasonable steps to ensure that the client understands that you have not taken into account their objectives, financial situation or needs in giving the general advice.**

Referral networks

10.23 According to the FPA, referral networks played a significant role in the massive consumer losses from Timbercorp, Great Southern, and other widely marketed schemes. It noted that referral advice was not regulated by the Corporations Act even where major financial decisions were at stake because this advice did 'not of itself constitute a financial product recommendation'. It was concerned with the role of business models that rely on referral networks providing adequate consumer protection.[27]

10.24 In addition to recommending replacing the general advice definition with a term that would not pose the risk of misleading retail clients about the service they are being provided, the FPA recognised the need to:

- investigate the role that referral networks played in the distribution of failed forestry and agribusiness managed investment schemes; and
- examine whether consumers are adequately protected from referral strategies intended to transition between legal and regulatory frameworks of varying levels of consumer protection.[28]

Recommendation 11

10.25 In light of the concerns about the lack of understanding about the role that referral networks had in selling agribusiness MIS without appropriate consumer protections, the committee recommends that the government's consideration of 'general advice' also look closely at the role of referral networks and determine whether stronger regulations are required.

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27 *Submission 161*, p. 3.

28 *Submission 161*, p. 3.

Gatekeepers—research houses

10.26 The FPA maintained that other gatekeepers, such as research houses, had also failed their obligations to retail investors.[29] It observed that in the case of forestry MIS collapses and the resultant massive consumer losses, the shortcomings of gatekeepers within research houses, AFS licensees, responsible managers, and product issuers have been understated.[30] In this regard, the FPA raised an important matter that warrants close consideration—the role of research houses in promoting the agribusiness MIS.

Role and function of experts' reports

10.27 Research or experts' reports provide another important source of information for financial advisers and investors in agribusiness MIS and were often a major selling point for agribusiness MIS. For example, Dr Judith Ajani explained that typically PDSs for plantation MIS do not include 'any direct statement or information about forecast project returns'. Instead, she noted, that relevant information was presented in 'an independent (forestry consultant) expert's report included in the PDS, but limited to forecast wood yields and prices'.[31] The committee has considered, and commented on, the unreliable yield projections contained in prospectuses and PDSs in agribusiness MIS.[32]

10.28 An RE would normally engage external experts to provide potential investors with independent opinion on what they 'consider to be reasonable agricultural performance parameters' for the scheme. For example, in 2008, Great Southern explained that the soundness of an MIS project structure was 'further ensured by independent research houses'. It then described the work of those research houses:

> Assessment of the project viability by these credit rating agencies is extremely thorough and all assumptions used in the MIS operator's financial model under scrutiny, including past performance, management skills and an assessment of the MIS company's corporate governance. A range of sensitivities is provided whereas the potential investor is being made aware of the assumptions the project is most sensitive to (i.e. commodity price or yield or both)…Project weaknesses and benefits are highlighted as applicable throughout the report culminating to what the research house

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29 *Submission 161*, p. 5.

30 *Submission 161*, p. 4.

31 Judith Ajani, 'Climate change policy distortions in the wood and food market', Contributed paper to the Australian Agricultural and Resource Economics Society National Conference 2010, Adelaide Convention Centre, 8–2 February 2010 in Dr Judith Ajani, *Submission 26*, p. 13.

32 See paragraphs 9.26–9.35.

> considers to be a reasonable rate of return for the project and a project rating is finally issued.[33]

10.29 These independent reports were a critical component of the marketing strategy. Mr Bryant noted that insurers would not have given any adviser indemnity insurance unless they had something like the research report to back up their decision to recommend it to their clients.[34] Mr Peterson, general manager of distribution at Timbercorp from September 2004 to December 2009, explained further:

> …if you were a dealer group, whether you were owned by ANZ, NAB, CBA or Westpac, or whatever dealer you belonged to, for the research committees to put your product on the APL, the approved product list, they needed a research report from AAG, Adviser Edge or Lonsec. Without those reports, they would not put the Timbercorp, Great Southern or Macquarie Forestry projects on their approved product list.[35]

10.30 Representatives from FPA highlighted the importance of having robust research sit behind any analysis of products. Mr Rantall told the committee that he had sat on approved product committees for 30 years and noted the reliance placed on research that 'comes across your desk'.[36] Thus, research reports perform a valuable 'gatekeeping' function in the financial advice industry for both financial advisers and retail investors by:

- identifying products to consider for inclusion on approved product lists;
- assisting financial advisers to formulate financial advice for retail investors; and
- providing research for use directly by retail investors in making investment decisions.[37]

10.31 It is also important to note that the ATO advised the committee that part of the process of issuing a product ruling involves the applicant providing an independent expert's opinion on the scheme that go to matters such as management decision on the location, species and number of trees. The ATO relies on these opinions when it is

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33 Great Southern Limited, submission to the Review of Non-Forestry Managed Investment Schemes, September 2008, p. 11, http://archive.treasury.gov.au/documents/1423/PDF/Great_Southern_Limited.PDF (accessed 7 September 2015).

34 *Proof Committee Hansard*, 12 November 2014, p. 23.

35 *Proof Committee Hansard*, 12 November 2014, p. 24.

36 *Proof Committee Hansard*, 6 August 2015, p. 28.

37 ASIC, Regulatory Guide 79, *Research report providers: Improving the quality of investment research*, December 2012, paragraph RG 79.2 and a joint report by the Treasury and the Australian Securities and Investments Commission, *Review of credit rating agencies and research houses*, October 2008, paragraph 94, http://download.asic.gov.au/media/1343114/rep143.pdf (accessed 1 September 2015).

considering whether the investors 'are carrying on a business for determining the deductibility of expenditure'.[38]

Opinions for hire

10.32 Although often cited as independent research, product issuers commission such work as a way to promote their products. This user pays business model, whereby the product issuer directly reimburses the researchers, has the potential to undermine the independence of their findings. There may well be a conflict of interest—an incentive for researchers to downplay the negative aspects of the scheme they are reviewing and provide positive ratings.

10.33 In the context of a research report provider rating a scheme, ASIC explained further the nature of the potential conflict of interest:

> …the conflict arises as a result of the RE generally paying for the rating and providing the research report provider with information about the product, including, but not limited to yield information. The research report provider should manage any conflict that may arise as a result of these arrangements. If they fail to do so, ASIC may take action to sanction them, such as administrative action.[39]

10.34 In its 2009 report, the PJC referred to the practice of product producers obtaining opinions for hire. It recognised that independent experts had a critical role in promoting an agribusiness scheme but that questions had been asked about the independence and quality of their advice.[40] The same concerns were again raised during this current inquiry.

10.35 The committee has noted that the projected yield rates for some agribusiness MIS were overly ambitious, and that this fact became increasing apparent as earlier plantations were harvested. The committee has also noted that some schemes were located in unsuitable areas—poor soil or removed from vital infrastructure—or involved the wrong species being planted. Yet, expert reports did not reflect such concerns. In this regard, ASIC informed the committee that in the past it found:

> …investment products that failed (including agribusiness schemes) were either highly rated or the subject of very recent positive recommendations by research houses just before the product failure.[41]

10.36 ANZ referred to ratings given to Timbercorp:

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38 ATO, answer to questions on notice, No. 4, received 8 October 2015; Mr Tim Dyce, *Proof Committee Hansard*, 14 October 2015, p. 11.

39 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 28.

40 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into aspects of agribusiness managed investment schemes*, September 2009, p. 58.

41 *Submission 34*, paragraph 151.

> In the two years leading up to Timbercorp's collapse in 2009, external research houses with experience in forestry and non-forestry managed investment schemes rated Timbercorp investments as 'Investment Grade' or above.[42]

10.37 A number of witnesses were particularly concerned about the apparent lack of independence of experts commissioned to report on MIS. Ms Jan Davis, former CEO of the Tasmanian Farmers and Graziers Association, informed the committee that the prospectuses were 'always written by people who had a vested interest' and paid by the proponents of the scheme.[43] Mr Cornish similarly thought there was a problem with so-called 'independent advisers', such as Adviser Edge and AAG, that were giving non-commercial schemes four out of five stars and whose ratings were included in prospectuses. He cited a magazine that went out to financial planners at the time, including their list of 4½ and five stars. He cited one in particular that AAG rated 4½ out of five stars, despite the scheme having 'some really interesting corporate governance issues'. He stated further that they were producing investment support advice that was clearly flawed and further 'these organisations were paid—even though they called themselves 'independent'—by the promoters to provide this information'.[44] In summary, Mr Cornish argued:

> …where you have the so-called keepers of the keys or the people who base the ratings, saying, 'This is an investment that you would invest in', being paid by the promoter, you have, simply, a breakdown in proper due diligence being carried out.[45]

10.38 Mr Tom Ellison was also critical of the research reports. He noted that some of the AFSL had in-house research houses but others relied on external reports. For example, he informed the committee that most of the advisers in Tasmania relied on research reports from Aspect Huntley, whom he thought had given a 4½ star rating to an FEA product. He was of the view that a Perth based company was commissioned to undertake research and was pushing Great Southern, Gunns and FEA and rating them all five stars.[46] Mr Ellison indicated that some of the independent research he had seen was 'basically cut and pasted from the promoters' promotional material'.[47]

10.39 Mr John Lawrence attributed the damaged caused by failed MIS to, first and foremost, the promoters who organised the schemes but also the professionals who

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42 *Submission 145*, paragraph 66.

43 *Proof Committee Hansard*, 5 August 2015, p. 24.

44 *Proof Committee Hansard*, 4 August 2015, p. 12.

45 *Proof Committee Hansard*, 4 August 2015, p. 12.

46 *Proof Committee Hansard*, 4 August 2015, p. 22.

47 *Proof Committee Hansard*, 4 August 2015, p. 23.

signed off on opinions that formed part of the PDS.[48] Similarly concerned about the reliability of experts' reports, Mr Samuel Paton argued:

> …the Timbercorps and Great Southerns etc and the so-called agribusiness investment houses, who were paid to promote their schemes, were never subject to any independent government audit as to the veracity of the claims that were being made in their promotional literature and their ASIC and ATO sanctioned PDSs.[49]

10.40 Mr Bryant, who was employed by Timbercorp to deal with the research houses to obtain the necessary reports, suggested that the research houses provided advisers with a 'Teflon raincoat'.[50] He explained that the process for engaging a research house would normally involve a fee of around $35,000 per report. Basically, according to Mr Bryant, Timbercorp furnished the research houses with all the information that they requested and the houses, while relying on forestry or horticultural information, did not undertake independent analysis.[51] Mr Bryant also indicated that it was common practice for a company to avoid engaging a research house that may not provide the required rating. He referred to some companies not approaching Lonsec for certain projects because 'they knew that Lonsec would not give them the rating they wanted'.[52] He gave the example, where:

> …there were certain projects Great Southern did not get Lonsec to do, like their trees, because they knew that Lonsec would not give them an investment-grade rating.[53]

10.41 He noted further that 'other research houses like Mercer and Morningstar refused to rate these sorts of projects'. Mr Bryant observed:

> You have to remember that the research houses, whilst they did not check the pH or get an agronomist's report and those sorts of things, they did write the reports based on information provided by the promoter—in the case of Timbercorp products, Timbercorp. They did get out of their offices and go and kick the dirt and have a look, and they did have some very fine young minds working with them who had masters in agri et cetera and understood a little bit about what they were looking at. That can be a defence for them and it can be a negative for them as well.[54]

10.42 Mr Jeff Morris was also critical of the research houses that played their part in the marketing of agribusiness MIS by 'providing defective product ratings, on which

48 *Proof Committee Hansard*, 5 August 2015, p. 5.

49 *Submission 149*, p. 3.

50 *Proof Committee Hansard*, 12 November 2014, p. 22.

51 *Proof Committee Hansard*, 12 November 2014, p. 23.

52 *Proof Committee Hansard*, 12 November 2014, p. 24.

53 *Proof Committee Hansard*, 12 November 2014, p. 24.

54 *Proof Committee Hansard*, 12 November 2014, p. 24.

these professional advisers sought to rely and used to help sell these products'.[55] The FPA maintained that, as important gatekeepers, research houses had neglected their responsibilities.[56]

Obligations

10.43 The FPA suggested that research houses should be included in a review of the obligations of the main gatekeepers in the creation, operation, marketing, and distribution of forestry and agribusiness managed investment schemes.[57] It argued that ASIC must have the legislative power to hold each participant accountable for the responsibility they have to the consumer for the 'gatekeeper' role they play, and the consumer's compensation needs.[58]

10.44 In 2012, ASIC issued a regulatory guide with the intention of creating 'an environment where the research produced by analysts for clients is objective, clear, fair and not misleading'.[59] This objective is consistent with international regulators as set out in the IOSCO's *Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest.*[60]

10.45 Two of the core measures in this statement of principles have particular relevance to this inquiry into agribusiness MIS. They are designed to hold analysts to high standards of integrity by:

- imposing general legal obligations on analysts and/or the firms that employ analysts to act honestly and fairly with clients; and
- prohibiting analysts and/or the firms that employ analysts from acting in ways that are misleading or deceptive.[61]

10.46 The IOSCO also suggested the following additional measures for its members to consider:

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55 *Proof Committee Hansard*, 12 November 2014, p. 42.

56 *Submission 161*, p. 5.

57 *Submission 161*, p. 5.

58 *Submission 161*, p. 4.

59 ASIC, Regulatory Guide 79, *Research report providers: Improving the quality of investment research*, December 2012, paragraph RG 79.44, http://download.asic.gov.au/media/1239863/rg79-published-10-december-2012.pdf (accessed 7 September 2015).

60 The International Organization of Securities Commissions' (IOSCO) *Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest*, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf (7 September 2015).

61 The International Organization of Securities Commissions' (IOSCO) *Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest*, p. 10, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf (7 September 2015).

- imposing 'fit and proper' requirements or otherwise prohibiting individuals with criminal records or demonstrably compromised integrity from being employed, indefinitely or for a period of time, as analysts;
- requiring analysts to take periodic examinations designed to test analysts' knowledge of their legal and ethical duties;
- making the disciplinary records of analysts public;
- requiring analysts to disclose their professional credentials in research reports distributed to investors;
- requiring analysts to define the terms they use when making recommendations; and
- requiring analysts to include in their reports a discussion of the assumptions underlying their recommendations and a sensitivity analysis to help investors understand how changes to these assumptions may affect the analysts' conclusions.[62]

10.47 While ASIC's Regulatory Guide RG 79 on research report providers is helpful in providing a useful guide on measures that research providers and product issuers commissioning reports should employ, the language is tame. For example, in respect of due diligence ASIC writes:

> We expect AFS licensees (including advice providers) to conduct appropriate due diligence in choosing a research report provider…[63]

10.48 Moreover, ASIC informed the committee of the incentives and sanctions that exist for research houses and experts to make sure that their ratings are objective and well-founded:

> …the incentive for research providers is compliance with their general licensing obligations and general conduct obligations such as the prohibitions against misleading or deceptive conduct.[64]

10.49 ASIC also noted that it had not reviewed the conduct of research houses since the last revision of RG 79 in December 2012.[65]

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62 The International Organization of Securities Commissions' (IOSCO) *Statement of Principles for Addressing Sell-side Securities Analyst Conflicts of Interest*, p. 10, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD150.pdf (7 September 2015).

63 ASIC, Regulatory Guide 79, *Research report providers: Improving the quality of investment research*, December 2012, paragraph RG 79.176, http://download.asic.gov.au/media/1239863/rg79-published-10-december-2012.pdf (accessed 1 September 2015).

64 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 31. ASIC provided a comprehensive answer to this matter of research houses and expert advice.

65 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 32.

Conclusion

10.50 The committee acknowledges that there are numerous participants who offer products or services within the financial advice value chain that influence, directly or indirectly, consumers' decisions on financial matters. It particularly notes that research houses and subject matter experts produce reports containing important information for financial advisers and investors in agribusiness MIS. Under the user pays model, the experts' opinions may be biased by the remuneration offered and the promise of further business. In the committee's view, research houses and experts providing opinions should be held to high standards of honesty and integrity. In this regard, the committee notes the relevant IOSCO statement of principles governing integrity and ethical behaviour and is of the view that they should apply and have force in Australia.

10.51 The committee is concerned that the message about compliance and adhering to high ethical standards is not reaching all participants in the industry.

Recommendation 12

10.52 In respect of research houses and subject matter experts providing information or reports to the market on financial products such as agribusiness MIS, the committee recommends that the government implement measures to ensure that IOSCO's statement of principles governing integrity and ethical behaviour apply and have force. In particular, the committee recommends that the government consider imposing stronger legal obligations on analysts and/or firms that employ analysts to rate their products, to act honestly and fairly when preparing and issuing reports and applying ratings to financial products.

Chapter 11

Role of banks

> I was not informed of the risk from NAVRA Financial advisors, I was not given a clear statement of advice, they did not consider my personal situation and had inadequate insurance. The Banks then enabled this bad practice by agreeing to lend money when my serviceability and assets were insufficient and no loan documents were ever given, until requested through the FOS [Financial Ombudsman Service] process.[1]

11.1 In the previous chapters, the committee focused mainly on the conduct of, and advice provided by, financial advisers and scheme promoters. Many of the growers, however, formed the view that the banks were in some way responsible for their current situation. They could not comprehend how they ended up in such parlous financial straits and clearly attribute their plight not only to their advisers' poor advice and unethical behaviour but to the complicity of the banks in financing their loans. In this chapter, the committee considers the role of the lenders in financing investors in MIS. The focus is on two banks in particular: the ANZ, which provided finance through Timbercorp Finance; and Bendigo and Adelaide Bank, which provided finance through Great Southern Finance.

11.2 Further, when the schemes collapsed, a number of growers complicated their financial predicament by following legal advice to stop making repayments on their MIS loans. The committee considers this matter in the following chapter.

Banks and responsible lending

11.3 Many investors caught out by the collapse of agribusiness MIS and burdened with significant loans were of the view that the banks should have taken more care and exercised due diligence when providing finance for the products.[2] For example, one such couple, referred to the banks' role in providing margin loans, warrants and loans for agricultural schemes without verifying the borrower's ability to repay.[3] They stated:

> Why were the banks allowed to fund these schemes as they did? Where were their responsible lending practices back then? For Tony and I, the 2007 and 2008 schemes combined came to approximately $286,000 between us. Even at the time of the last 2008 scheme we did not have sufficient assets to repay this amount. We could not have met serviceability

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1 Name withheld, *Submission 63*, p. [2]. It should be noted that Bendigo and Adelaide Bank responded to this submission as well as a number of others who criticised the bank.

2 Miles and Marion Blackwell, *Submission 173*, p. 1.

3 *Submission 65*, p. 1.

> criteria with which to repay this at the time, let alone now, 5 years later with accumulated and penalty interest added on top.
>
> The repayments for both schemes between us interest only were approximately $2,300 per month, and when the capital began to be repaid this would total over $4,500 per month—this is more than a $1 million mortgage!!! Yet our 2006 tax return showed $95,000 income between us. Why were the banks allowed to lend this amount, when it was quite clear we would not be able to repay, should the grapevine returns not materialise? Everything hinged on the grapevines producing returns—without this, there was no way for us to repay the loans—so why were the banks allowed to lend on this basis?[4]

11.4 This investor asked, as did a number of other investors, whether Bendigo and Adelaide Bank acted lawfully or ethically when it failed to assess properly and approve each and every loan application and did not review the ability of investors to service their loan—could they actually afford the loan liability should the returns not transpire. There were also concerns about the bank:

- neglecting to point out to investors that should the grapevine returns fall short, they would be expected to service the loans and that their homes and other assets would be at risk if they did not;
- allowing investors to sign up under the illusion that this was a safe, self-funded investment backed by the Australian Government to encourage investment in agriculture;
- misleading investors into thinking that their loans were directly tied to the vinelots they purchased, giving them maps and details as to where their little pieces of land were; and
- providing commissions of 10 per cent to the accountants and financial advisers informing the investors.[5]

11.5 Some investors also levelled allegations of lax lending practices. For example, one investor with Great Southern stated:

> It would have also been beneficial if Bendigo bank had provided a clear concise copy of the loan application form! That way I would have been afforded the opportunity to clearly see the loan I was applying for.[6]

11.6 The investor went on to state that Bendigo and Adelaide Bank took no responsibility to ensure that Great Southern was doing the right thing in their practices or to whom they were lending money. He explained that the bank did not check to ensure that he met the lending criteria—that he could repay the money:

4 Name withheld, *Submission 56*, pp. [4]–[5].

5 Name withheld, *Supplementary Submission 56.1*.

6 Name withheld, *Supplementary Submission 52*, p. [2].

> As I'm sure you've been told the Banks position is 'we had a loan servicing agreement in place with Great Southern, so if Great Southern did the wrong thing then it is not our fault'. Not responsible lending at all!
>
> Great Southern imploded in 2009 and Bendigo Bank have engaged bully boy tactics and are demanding full repayment of the loans at over 10% interest, plus early exit fees.[7]

11.7 This investor called on the bank to 'show some corporate and social responsibility/conscience'.[8]

11.8 A number of submitters argued that the banks should have exercised greater care when providing finance and been aware that the schemes were in trouble, with some suggesting that the banks were supporting insolvent companies.[9] In their view, the banks that were funding the schemes should have known better. For example, one submitter stated:

> Bendigo Bank claims that it is not responsible for the actions of its agent (GS Finance Pty Ltd) even though it provided hundreds of millions of dollars to fund GS projects—a Ponzi-like scheme that could not have operated without that funding. This had, apparently, been going on for some time prior to the GS collapse.
>
> So, why did Bendigo Bank provide millions of dollars through its agent (GS) to investors for MIS projects that did not or only partially ever exist?[10]

11.9 The investor could not fathom why the banks did not conduct due diligence and gave the example:

> …if I was to build a new house with a bank loan obtained from a broker, I'm sure the bank would want confirmation that a house could be built to that valuation and then confirm it actually was built at some point in time to secure their investment.[11]

11.10 Based on the succession of events in the Great Southern debacle, he could only conclude that 'Bendigo Bank sought to recover its own bad debts at the expense of misled and innocent investors'.[12]

11.11 Mr Huggins chronicled what he believed were the problem areas of the banks involvement in providing loans to retail investors in MIS, in this case the Commonwealth Bank of Australia (CBA). In his view, conflicts of interest were at the

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7 Name withheld, *Submission 52*, p. 1.

8 Name withheld, *Submission 52*, p. 1.

9 Name withheld, *Submission 100*, pp. 11–12.

10 Name withheld, *Submission 91*, p. [2].

11 Name withheld, *Submission 91*, p. [2].

12 Name withheld, *Submission 91*, p. [2].

very core of these problems. He was surprised that the CBA apparently entered into an arrangement where:

- it would provide finance for what were well understood to be highly speculative investments;
- the promoter acted as the administrator with respect to the finance that was to be provided by the CBA;
- the person who was providing advice about the scheme (and who stood to make a substantial commission if that advice was accepted) also produced evidence as to the client's income;
- the entire process from completing an application to making an investment/application for finance and for funds to be drawn down took approximately 24 hours;
- funds would be drawn down with respect to a loan before the client was informed as to the terms of the loan—the implication being that this was done so as to give the client no opportunity to consider their position and no opportunity to attempt to get out of the investment; and
- the Confirmation Notice (this document was not produced until months after the loan had been drawn down) and bank statements (this went on for a number of months) with respect to a loan would be sent to the promoter of the scheme instead of the client.[13]

11.12 Mr Peter Jack held the view that:

> The banks and other major institutions who underwrote this venture and also had their advisors sell this product need to be held accountable. I find it unfathomable that a bank such as ANZ can post billion dollar profits and consciously destroy the lives of so many Australian families this is corporate greed…[14]

11.13 Mr Craig Stranger, Managing Director of PAC Partners, formed the view that payments sought by KordaMentha on behalf of the Timbercorp banks were 'neither fair, nor reasonable'. In his opinion, the very same banks were the stakeholder most 'inside the tent' of Timbercorp, and therefore 'implicit in growing the business, plantations and therefore risk profile aggressively'. In his words:

> To show 'all care and no responsibility' after the event, and still seek full interest from unsophisticated retail investors is both immoral and unjust in my strong view.[15]

11.14 Investors were particularly upset with the banks for apparently placing their own interests before those of the borrowers. One investor indicated that the biggest

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13 *Submission 118*, p. 7.

14 *Submission 25*, p. 1.

15 *Submission 16*, p. 1.

risk was the company itself collapsing but even then, 'the bank could still recover its money from the growers—the loan documents were written to ensure this'. Referring to Timbercorp MIS, he explained:

> By insisting that the company finance itself through 'growers' who notionally borrowed money from Timbercorp Finance notionally provided by the bank, the bank was insulating itself from any risk associated with the company's performance or even the company's very existence.[16]

11.15 According to the investor, because the true nature of the investment had not been explained, the growers' were 'the Turkeys who…were taking all the risk off the shoulders of the bank'.[17]

ANZ

11.16 ANZ was one of a number of lenders to the Timbercorp Group and was aware that 'many Timbercorp investors borrowed from Timbercorp Finance or other lenders to purchase their investment'.[18] ANZ informed the committee that it provided finance to the Timbercorp Group: that 'the relationship was broad and extended beyond the $150 million grower loan facility with Timbercorp Finance'. Total ANZ lending to the group was around $500 million. ANZ made clear that:

- in early 2003, ANZ entered into loan securitisation arrangements with Timbercorp Finance, and later also provided it with a 'grower loan facility'—the securitisation allowed Timbercorp to securitise the grower finance so that the Group itself did not have to fund the full amount of the grower loans;[19]
- ANZ did not provide direct loans to Timbercorp investors and had no direct relationship with growers who borrowed money from Timbercorp Finance;[20]
- applications for investor loans were received, assessed and processed by Timbercorp Finance;[21]
- ANZ reviewed the Timbercorp Finance standard loan documentation, the loan application process, credit policy and procedures manual, and procedures for collecting and handling arrears as part of its due diligence and ongoing monitoring and assessment of the securitisation program; and
- ANZ regularly conducted analysis and testing of loan portfolio data and received monthly reporting on the portfolio, including information on compliance with pool parameters, default rates and arrears.[22]

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16 Name withheld, *Supplementary Submission 186.1*, p. 2.

17 Name withheld, *Supplementary Submission 186.1*, p. 2.

18 *Submission 145*, p. 8.

19 *Submission 145*, p. 11.

20 *Submission 145*, p. 10.

21 *Submission 145*, p. 11.

11.17 Commenting on its oversight of Timbercorp Finance, ANZ observed:

> Copies of completed loan documentation were held by Timbercorp Finance, not ANZ. However, ANZ performed a sample review on an annual basis of Timbercorp's borrower loan files. This sampling process did not disclose any irregularities in the borrower loan documentation reviewed. The staff, who conducted the audits on Timbercorp Finance, analysed the monthly reports and reviewed the credit processes and procedures, were familiar with standards for retail loan credit and reported their findings to an experienced team at ANZ who was satisfied with the reported processes.
>
> The monitoring and assessment performed by ANZ, as lender to Timbercorp Finance under the grower loan facility, mirrored that performed by ANZ's securitisation team.[23]

11.18 ANZ explained further that its credit rating of Timbercorp to April 2007 was 'quite good'; from April 2007 to July 2008 was 'acceptable'; and from that date until the collapse of Lehman Brothers in September 2008 was 'satisfactory'.[24] It maintained that its assessment of Timbercorp over the years was 'careful and responsive':

> In the 15 years of Timbercorp's existence leading up to 2009, Timbercorp's business was scrutinised by regulators, analysts, management, investors and other lenders, none of whom identified any particular or systemic flaw. It is not appropriate now to overlay that assessment with the knowledge of hindsight and the particular impact of the unfolding global financial crisis on Timbercorp.[25]

11.19 As at October 2014, investor-borrowers owed Timbercorp Finance $489 million. ANZ informed the committee that secured creditors, including ANZ ($93 million for Timbercorp Finance plus $14 million for Timbercorp Finance Trust) have specific rights to the repayments received on certain pools of loans.[26]

Resolving difficulties with outstanding loans

11.20 According to KordaMentha, the liquidator appointed to Timbercorp, at November 2014, the Timbercorp loan book had approximately 2,800 borrowers with 6,700 loans outstanding. The majority were in default and subject to legal recovery. At that time, it informed the committee that:

> Loan recovery was stayed from June 2009 to May 2014 while the Grower Investors pursued a Class Action through the Victorian Supreme Court, the Appeals Court, and ultimately dismissed by the High Court of Australia.

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22 *Submission 145*, p. 11.

23 *Submission 145*, p. 11.

24 The collapse of Lehman Brothers was a very large and significant corporate failing that unsettled world markets and marked a new phase in the global financial crisis.

25 *Submission 145*, pp. 27–28.

26 *Submission 145*, p. 28.

> Given the duration of the Class Action, we are approaching the statute of limitations period to commence recovery action against borrowers who remain in default and have instructed solicitors to commence recovery proceedings.[27]

11.21 KordaMentha explained its strategy for debt recovery:

> Prior to commencing legal proceedings every borrower is contacted in writing to advise proceedings will be commenced and attempt to engage in meaningful discussions to deal with their outstanding loan(s). Given the passage of time and the emotional engagement of many borrowers in the Class Action there has been reluctance from borrowers to engage in discussions with the Timbercorp Finance collection team.[28]

11.22 If a borrower engages with KordaMentha's collection team and advises that they are unable to take up the early repayment discount (15 per cent) or prepayment discount (10 per cent), KordaMentha reported that it then:

- deals with them on a case by case;
- asks them to complete a Statement of Financial Position to determine what they can repay;
- subject to the individual facts and circumstances, may also choose to independently verify (at its cost) the factual position of the borrower;
- if it is as represented, KordaMentha would usually agree an arrangement to accommodate the borrower's financial circumstances.

11.23 When the borrower engages with KordaMentha, it has 'generally agreed terms that normalise the interest rate and provide repayment terms that the borrower can manage'.[29]

11.24 By August 2015, 5,300 borrowers no longer had a debt with Timbercorp Finance. The remaining 2,200 with outstanding debts to Timbercorp Finance, which amounted to $380 million, had three options as outlined by Mr Korda:

- settle with a 15 per cent discount, which is non-negotiable;
- continue to litigate; or
- join the hardship process.[30]

11.25 Many submitters were highly critical of the conduct of the Timbercorp liquidators and ANZ. One such investor suggested that ANZ had directed the administrator KordaMentha to 'show no mercy and get every cent they could at

27 Mr Mark Korda, correspondence to committee, 5 November 2014.

28 Mr Mark Korda, correspondence to committee, 5 November 2014.

29 Mr Mark Korda, correspondence to committee, 5 November 2014.

30 *Proof Committee Hansard*, 6 August 2015, p. 14.

13.5 % compound interest'.[31] A Timbercorp grower, Mr Tim Stanford, explained that the Agriculture Growers Action Group (AGAG) presented KordaMentha with a commercial settlement proposal, which was supported by a robust set of data. In his words, KM 'have not even entered the negotiating room on this but instead continue to offer a paltry and derisory 15% discount which has been rejected three times by Growers'.[32] As many investors observed 'In the time this has taken the debt of every Grower has doubled!' Mr Stanford stated:

> Instead they (KM) continue to pursue individuals (like a hunting pack) for legal debt recovery at a snail's pace, notionally safe in their belief that a 13% penalty interest rate makes a slow resolution the best commercial outcome for them.
>
> This strategy is absolutely ridiculous and not in the best interests of anyone but KordaMentha.[33]

11.26 He echoed the sentiments of many others:

> The ANZ have secured their money, the financial advisors have made their commission, KordaMentha are managing it in their best interests and the only person funding this is the poor investor who was duped in the first instance.[34]

11.27 Another grower complained:

> For the liquidators to be so forceful in trying to recoup our loans at such a high price is disgraceful and unfair. To have been a part of this investment for less than a year and now asked to pay back our loan with high interest and to have nothing to show for it is unbelievably unfair.[35]

11.28 It should be noted that once insolvency practitioners assume the administration and winding up of a failed scheme, they are required to recover any outstanding debts. In this regard, ANZ noted that a receiver's primary duty is only to collect and sell enough of the assets of the company to repay debt owed to secured creditors. A liquidator, on the other hand, is required 'to bring the company's affairs to an end and does not cease after secured creditors are repaid'. It stated further that in seeking repayment of loans from growers, the liquidator's specific duty is 'to salvage as much as possible for the benefit of creditors'. Further, collecting the assets of the company was part of a wider duty:

> In performing these duties, a liquidator is required to act impartially and to exercise appropriate skill, care and diligence. To comply with these duties,

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31 Name withheld, *Submission 42*, p. 5. See also, name withheld, *Submission 53*, p. 1 and *Submission 54*, p. [1].

32 Mr Tim Stanford, *Submission 17.* See Dinu Ekanayake, *Submission 21*, p. 1.

33 *Submission 17*, p. 1.

34 *Submission 17*, p. 1.

35 Name withheld, *Submission 18*, p. 1.

> a liquidator must have a proper basis to settle or compromise a debt, such as borrower hardship.[36]

11.29 KordaMentha also made clear that liquidators have a statutory duty to secure, preserve and receive assets for the benefit of all its creditors.[37]

Hardship provisions

11.30 One group of investors with Timbercorp felt particularly aggrieved about their current situation. They were clients of the Holt Norman Ashman Baker firm and had formed an action group—the HNAB–AG. As noted earlier, ASIC has banned Mr Holt for three years because, among other things, he failed to comply with numerous financial services laws.[38]

11.31 Mr Graham Hodges, Deputy CEO of ANZ, informed the committee that through his discussions with this action group, members of the senate economics committee and others, the bank had worked 'to support a more accessible, transparent and empathetic hardship program for Timbercorp investors'. He noted that the Holt Norman affected Timbercorp investors were being given special attention to help resolve their difficulties. According to the bank, a major initiative involved the liquidator appointing an independent advocate in September 2014 to assist and represent investor borrowers in financial hardship. Mr Hodges indicated that KordaMentha regularly updated him on the hardship program and the work of the advocate, Ms Catriona Lowe. He stated further:

> While we only have a limited ability to influence those outcomes we are encouraged by the quick and fair settlements that are occurring.[39]

11.32 In August 2015, Mr Mark Korda provided detail on the hardship process that had been in place since the end of the litigation, and of the substantial enhancements over the previous 12 months, including the appointment of the independent hardship advocate (IHA). He maintained that Ms Lowe was very well credentialed and was there to help people in hardship resolve their issues. He explained:

> She has an independent mandate and she is fiercely independent—recognising, though, that the borrowers do not have to pay her; Timbercorp pays her. She has a small team and works independently with all the borrowers. She also appoints independent former financial counsellors to assist the borrowers. The borrowers do not pay for any of these costs. We pay for them. Why is that? It is not anything magnanimous, we just think it is a good business decision. We need to clean this up and the sooner we

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36 *Submission 145*, p. 28.

37 Additional information provided by KordaMentha, 4 December 2014, p. 2.

38 For detailed information see paragraph 8.37, and accompanying footnote 32.

39 *Proof Committee Hansard*, 6 August 2015, p. 53. KordaMentha approached Ms Catriona Lowe in November 2014 to discuss the role of the IHA. Ms Lowe commenced her role as IHA in December 2014. Ms Catriona Lowe, *Submission 200*, p. 1.

> clean it up, the quicker we can get out of there and the creditors get their money.[40]

11.33 Ms Lowe understood that the IHA program and the internal Timbercorp hardship process were 'the first of their kind in the world'.[41] She drew comparisons with the program to expedite the delivery of compensation to investors in Bernard Madoff's scheme in the United States and hardship programs in Australia offered by credit providers, utilities and the ATO. Ms Lowe acknowledged:

> The critical difference between these processes and the IHA program is the presence of adviser negligence, misconduct or deceit in a significant number of Timbercorp cases. In the other markets mentioned there are separate, and usually free processes to examine, and if appropriate provide redress for, misconduct. In the case of credit providers and utilities there are industry based EDR schemes and in the case of the ATO there is the Commonwealth Ombudsman. Whilst industry based EDR theoretically provides this redress for poor adviser conduct, in reality this redress is stymied by the limitations of adviser solvency and PI insurance.
>
> This difference is important not only in that it demonstrates a significant gap in the system, but critically in how it affects the expectations of applicants to the IHA program and KM.[42]

11.34 The committee looks at dispute resolutions mechanisms available to investors in MIS in chapter 17.

Progress under the hardship program

11.35 According to Mr Korda, as at 6 August 2015, there were 395 applications in hardship process, 110 had been dealt with and two had been rejected.[43] Elaborating on this process of determining eligibility for the hardship program, Mr Korda explained:

> You can go into the hardship process for many reasons: ill health, disability, business failure, loss of job, loss of long-term employment, death, divorce or bad advice from financial planners.[44]

11.36 Mr Korda stressed, however, that 'it is the position you are in, not the reason, that will determine the outcome of our hardship process'. He stated that KordaMentha consider the person's ability to repay the loan and, to emphasis this fact, repeated that it was the current circumstances that would determine the result and not the source of the problem.[45] He explained:

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40 *Proof Committee Hansard*, 6 August 2015, p. 15.

41 Ms Catriona Lowe, *Submission 200*, paragraph 19.

42 Ms Catriona Lowe, *Submission 200*, paragraphs 21–22.

43 Mr Mark Korda, *Proof Committee Hansard*, 6 August 2015, pp. 15 and 19.

44 *Proof Committee Hansard*, 6 August 2015, p. 14.

45 *Proof Committee Hansard*, 6 August 2015, p. 14.

> It's about whether you can pay or not, and let's deal with that issue, not the root cause of it.[46]

11.37 To illustrate what he meant by hardship, Mr Korda gave the example of a person who may owe $50,000 and have a house worth $500,000 with no mortgage. In his words, 'that is not hardship'.[47]

11.38 As noted earlier where hardship is not established, the current maximum discount that Timbercorp Finance is offering is 15 per cent: that is a lump sum payment of 85 per cent of the existing balance, which is the principal and accrued interest. Ms Lowe noted that cases that settle at 70 per cent or higher 'necessarily involve payment of a significant component of interest'.[48]

11.39 Ms Lowe informed the committee that where hardship is established the majority of cases, but not all, settle for between 20 and 70 per cent, which is a significant range. There are three broad categories:

- serious financial hardship, where a person has limited or no assets and no significant earnings once expenses are deducted;
- serious non-financial hardship, which cannot be termed serious financial hardship cases but where other serious elements are present such as 'significant physical or mental health issues'; and
- other cases where the elements of hardship are at a lower level and where some discount may be achieved but of lesser magnitude than for the two cases cited above.

11.40 Ms Lowe noted that the serious non-financial cases were the ones most likely to cause the IHA and KordaMentha to disagree on the appropriate resolution.[49]

Criticism of the IHA process

11.41 It should be noted that the spokespersons for the HNAB—AG have written to the committee expressing their strong disappointment with the hardship program. Their complaints include the time taken to conclude matters—many months, not a couple of weeks—and 'significant errors' made by the advocate in determining the statement of the financial position of at least two borrowers.[50] They also pointed to a number of alleged inaccurate statements made by Mr Korda in his testimony before the committee, including:

46 *Proof Committee Hansard*, 6 August 2015, p. 16.

47 *Proof Committee Hansard*, 6 August 2015, p. 20.

48 Ms Catriona Lowe, *Submission 200*, paragraph 49.

49 Ms Catriona Lowe, *Submission 200*, paragraphs 12–18.

50 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, pp. [1]–[2].

Inaccuracy in relation to KordaMentha's acceptance of IHA proposals. 23% were rejected by the liquidator at May 2015. This continues to occur at October 2015. In a recent case the IHA recommended waiver: however, the liquidator rejected it and demands a six figure sum.

Inaccuracy regarding conclusion amounts and sensitivity to concerns. Contrary to the assertion of not being concerned with interest, KordaMentha pursues accrued interest on debt even demanding close to, or as much as 85%: this is the amount the liquidator pursued at the outset before the program (not 0–40% of doubled debt as claimed). There is reason to believe amounts demanded are arbitrary and involve agenda.[51]

Delays and inaccuracies

11.42 KordaMentha informed the committee that while the hardship program was 'in line with best practice', the time taken to resolve hardship claims was one facet of the process that was falling short.[52] He attributed the delay to two main causes:

- KordaMentha not actively pushing borrowers to provide information required to assess the hardship claim—KordaMentha is 'content to wait' for borrowers to provide the information 'without pressure of a defined timeframe'; and
- once a settlement offer is provided to a borrower, 'they may be unwilling to agree'. According to Mr Korda, 'we have been cautious to remove such borrowers from the hardship process, but we plan to take on a more proactive approach in this regard.[53]

11.43 Mr Korda provided the following update as at 23 December 2015[54]

Hardship claims		
Settlement agreement reached	179	40%
Settlement offer pending borrower acceptance	32	7%
Debtor petition bankruptcy (borrower files for bankruptcy)	5	1%
Rejected from hardship process	7	2%
Sub-total	**223**	**50%**
Review process on-going	220	50%
Total hardship claim	**443**	

11.44 According to Mr Korda, of the 443 total hardship claims to date, the hardship advocate had assisted 246 borrowers, settling 75 with 171 reviews ongoing.[55]

51 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, p. [1].

52 Additional information, Mr Mark Korda, 23 December 2015, paragraph 30.

53 Additional Information, Mr Mark Korda, 23 December 2015, paragraph 24.

54 Additional Information, Mr Mark Korda, 23 December 2015, paragraph 30.

55 Additional information, Mr Mark Korda, 23 December 2015, paragraph, 31.

11.45 Ms Lowe agreed with the view that the IHA process was 'taking longer than we would like'. From her perspective, the main reasons for the delay were:

- More people have sought to access the program than expected—since commencing the program, the IHA team has contacted more than 260 people involving more than 200 cases (as a number of cases involve a couple).
- At a number of points in the program it has been necessary to put the process of undertaking individual assessments and negotiations on hold in order to reach agreement with KM about the appropriate approach to particular issues or the parameters of the hardship program in general.
- The process has also been slowed by the need to facilitate communications regarding legal issues between Timbercorp and clients of the program (including the means of serving writs where the relevant limitation period is due to expire).
- Allowing people the time they need to engage.
- Information gathering can slow things down:
  - some people's financial situations are complex and therefore the amount of information needed to be gathered in order to understand the position can be extensive;
  - the mental health issues and level of anguish some people experience requires a careful and compassionate approach, which can take a significant amount of time and resource;
  - in some cases the process of assessment reveals that the information provided is incomplete and therefore further information is required;
  - often KM will require significant and detailed additional information in order to consider a proposal; and
- Complex negotiations can slow things down, particularly where IHA's assessment and Timbercorp's views are a long way apart.[56]

11.46 The IHA provided a different set of statistics on the progress made in resolving the hardship cases. They apply <u>only</u> to the cases that the IHA is managing.

Based on the flow chart which shows the various stages in the process, as at 20 January 2016:

- 20 matters (10%) were at the initial engagement stage, awaiting a referral to complete a statement of position;
- 32 matters (16%) were in the process of completing a statement of position;

56 Ms Catriona Lowe, *Submission 200*, paragraph 29. Ms Lowe's answer contains far more detail on the reasons for the delay.

- 16 matters (8%) were in the initial stages of assessment;
- 27 matters (14%) were in the final stages of assessment or awaiting final assessment;
- 36 matters (18%) were being negotiated;
- 66 matters (34%) have been settled;
- 1 matter (0.5%) has been classified as negotiations unsuccessful.[57]

11.47 In regard to the two errors that HNAB–AG mentioned, Ms Lowe was aware of only one such mistake. She explained that where such errors occur, IHA acknowledges, assesses and corrects their effect and, where the mistake is material in the context of a person's overall hardship situation, IHA's assessment is adjusted accordingly.[58]

Deed of settlement

11.48 Members of the action group were specifically concerned about a clause in the deed of settlement. Ms Susan Henry, Chair, HNAB–AG, claimed that Ms Lowe's solicitor colleagues advised people to sign a legal document that contained a false statement: namely that they were fully aware and informed on entering Timbercorp loans, consented and hence were responsible for the debt.[59] According to Ms Henry, KordaMentha argued that a clause accepting responsibility is required by law in order to release someone from the amount partially or in full to the ANZ. But in her view, this clause meant that effectively victims have no choice but to sign a legal document making a false statement, that they were informed and consented. She proposed rewording this clause in order to reflect the truth, which, in her view, would 'alleviate tremendous psychological distress—if still failing to provide justice'. Her proposed substitute clause could note:

> The debt (portion or full waiver) is determined as assessed within the parameters of the hardship program on the basis of the available documents which are considered to be legally binding regardless of how the person's signature was obtained and in view of there being no legally accepted proof under existing legislation that he or she was not aware, or properly informed, to consent. Claims of misconduct, deception and fraud have been alleged but have not been examined as the victim/s are in no psychological or financial position to pursue a criminal case and are mindful that no industry body exists which is competent and resourced to investigate. In

57 Ms Catriona Lowe, *Submission 200*, paragraph 28.

58 Ms Catriona Lowe, *Submission 200*, paragraph 38.

59 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, p. 18.

> addition, limitations of the legal system mean it is not a reliable avenue for achieving justice or determining facts.[60]

11.49 In respect of the wording of this particular clause in the deed of settlement, Mr Korda informed the committee that KordaMentha did not understand the allegation. He stated that Timbercorp Finance's settlement deeds for borrowers in the hardship program do not require borrowers to acknowledge that they were fully aware or informed on entering Timbercorp loans, consented and hence were responsible for the debt. It followed, according to Mr Korda, that there was no need for the proposed substitute clause.[61]

11.50 Commenting on the deed of settlement, Ms Lowe noted that KordaMentha had adopted a number of her suggested amendments to the document but not the complete removal of the confidentiality clause. KordaMentha did accept narrowing the scope of confidentiality requirements so that confidentiality only applies to the actual terms of settlement.[62] Even so, Ms Lowe formed the view that the agreement was 'sufficiently improved to justify going forward'.[63] She recognised the complex issues related to confidentiality and acknowledged that 'the absence of information about what to expect can exacerbate an already extremely difficult situation for people'.[64] Looking back, she informed the committee that it would have been preferable for the IHA and the liquidators to provide earlier information regarding the range of outcomes people might expect.[65] Ms Lowe explained further:

> …if programs such as the IHA program are to provide benefits, their credibility, consistency and fairness must be measureable. My view at this time is this program and future programs should borrow an idea from the External Dispute Resolution (industry ombudsman) sector. In that sector, outcomes are often confidential however the operation of the scheme, including audits of individual files, is subject to regular review and public report by an independent expert third party.[66]

Power to compromise debt and best interests of creditors

11.51 Ms Henry also noted that a legal mechanism existed by which KordaMentha has 'the power to choose to eliminate ('compromise') debt of amounts under $100,000 as well as seek the permission of creditors OR the court for debt over that amount'. In her assessment, this legal option 'has been, and continues to be, outright dismissed' in

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60 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, pp. 18–19.

61 Additional information, Mr Mark Korda, 23 December 2015, paragraphs 20–22.

62 Ms Catriona Lowe, *Submission 200*, paragraph 50.

63 Ms Catriona Lowe, *Submission 200*, paragraphs 51–52.

64 Ms Catriona Lowe, *Submission 200*, paragraph 55.

65 Ms Catriona Lowe, *Submission 200*, paragraph 55.

66 Ms Catriona Lowe, *Submission 200*, paragraph 56.

favour of pursuing borrowers who have been the 'victims of Mr Holt's collaboration with Timbercorp for misconduct-related debt'.[67]

11.52 In response to this observation, Mr Korda informed the committee that at a meeting of creditors in June 2009, the voting creditors passed a resolution unanimously that authorised the liquidators to, among other things, compromise a debt to the company if the amount claimed was more than $20,000.[68] KordaMentha has used this power to compromise 'a large number of debts owing to Timbercorp Finance'.[69] Mr Korda noted, however, that KordaMentha must exercise such authority 'in a manner consistent with its duty to act in the best interests of the company's creditors'.[70] Mr Korda explained further that the liquidators overriding purpose was to:

> …serve the best interests of those concerned in the winding up of the company, namely the creditors, and to ensure that action is taken for the proper realisation of the assets of the company or to assist its winding up. To do otherwise may constitute a breach of our duties as liquidators and render us liable to an action by a creditor or shareholder…[71]

11.53 As noted previously, a liquidator is obliged to pursue the interests of creditors diligently, thus any decision by the liquidator should be guided by such interests.

11.54 Overall, KordaMentha rejected the allegations that it had provided inaccurate or misleading information to the committee.

Loss of confidence in independent hardship advocate

11.55 Finally, Ms Henry highlighted a particular worry—loss of confidence in the independence of the IHA. She stated:

> The advocate's conduct is not that of an advocate but an intermediary for KordaMentha. Accounts underscore that victims are not treated with humanity or respect in the hardship program—indeed, distinct disdain is not uncommon.[72]

11.56 Ms Lowe's response to this criticism highlights the difficult task that confronts the hardship advocate and members of her team, who clearly appreciate that people should be treated with compassion and respect:

> Each member of the IHA team understands the gravity of the impact that the collapse of Timbercorp and subsequent events has had on the lives of

67 Ms Susan Henry, Chair, HNAB-AG, correspondence to Senate Economics References Committee, 27 October 2015, p. 1.

68 Additional information, Mr Mark Korda, 23 December 2015, paragraph 14.

69 Additional information, Mr Mark Korda, 23 December 2015, paragraph 15

70 Additional information, Mr Mark Korda, 23 December 2015, paragraph 16.

71 Additional information, Mr Mark Korda, 23 December 2015, paragraph 16.

72 Ms Susan Henry to Senate Economics References Committee, 12 November 2015, p. 2.

the people we work with. Indeed we are often witnessing that impact directly in our dealings with people. It is not possible to do justice to the devastation this situation has caused—the ripples that have spread through not only people's financial situations but also their relationships, their health and wellbeing and indeed their view of the world.

> The fact that [the] system is presently structured such that compensation is not practically obtainable when it is so clearly due only adds to the great sense of unfairness and injustice that attaches to the situation.

> Given this position it is understandable that a program that seeks to reduce debt payable rather than compensate for wrongs done may be considered inadequate.

> It is notable that despite this impact people are extraordinarily open, honest and responsive. In other cases, the trauma has clearly overwhelmed people's capacity to cope.[73]

11.57 Ms Lowe made the point that while she is paid by Timbercorp Finance, it does not employ her. She explained that her contract guarantees that she is not subject to direction and can terminate the agreement at any time if not satisfied with how the hardship programme is progressing.[74] Importantly, she identified a problem at the centre of the program which has clearly generated a deep sense of dissatisfaction with the IHA:

> …the profound mismatch between the expectations of applicants to the program and the liquidator, as to what the program should deliver.[75]

11.58 The committee agrees with Ms Lowe's view that this clash of expectations impedes the work of the IHA.

General assessment of the hardship program

11.59 From her perspective and summarising the effectiveness of the program, Ms Lowe stated:

> I initially accepted the engagement because I believed that I could assist borrowers in hardship to make arrangements that will make a real difference to their situation. However, it would be unacceptable for the program to provide the appearance of a solution if it is not delivering. For this reason, I feel it important to state publicly that I do not agree with the outcomes promoted by KM in all cases. Indeed in some cases I very strongly disagree.[76]

73 Ms Catriona Lowe, *Submission 200*, paragraphs 33–36.

74 Ms Catriona Lowe, *Submission 200*, paragraph 2.

75 Ms Catriona Lowe, *Submission 200*, paragraph 25.

76 Ms Catriona Lowe, *Submission 200*, paragraph 41.

11.60 Ms Lowe was concerned that recently the scope of disagreement had expanded. She acknowledged that while the program had succeeded in finding resolutions in the vast majority of matters to date, she was concerned about the prospects for future resolutions on terms she would consider to be reasonable. Noting that the program was at 'a critical juncture', she identified two primary elements in discussions with KordaMentha:

- the scope of the liquidator's duty, and in particular the meaning of 'best interests' in the context of a duty to act in the best interests of creditors; and
- consistency within the IHA program.[77]

11.61 Referring to Mr Korda's testimony, Ms Lowe noted that liquidators have a statutory duty to conduct liquidation in the best interests of creditors. Her research indicated that the discretion to grant waivers is guided by this overarching duty to creditors, which, to her mind, posed the question what 'best interests' of creditors means. In her view, an interpretation of 'best interests' should be broader than bare financial interest. She accepted, however, that 'the correct interpretation as the law currently stands is not clear and it may be narrower than desirable'.[78]

Committee view

11.62 The committee is disappointed that an adversarial mind-set is undermining the work of the IHA. The work of the IHA had the potential to defuse the confrontational and ultimately damaging relationship between the liquidator and the borrowers. The committee takes the view, however, that despite falling far short of HNAB—AG's expectations, the appointment of a hardship advocate still offers a more productive and constructive way to resolve long-standing disputes.

Recommendation 13

11.63 The committee recommends that KordaMentha continue, through its hardship program, to resolve expeditiously outstanding matters relating to borrowers who are yet to reach agreement on repaying their outstanding loans from Timbercorp Finance.

11.64 The committee recommends that spokespeople for HNAB–Action Group consult with KordaMentha and the Independent Hardship Advocate on implementing measures that would help restore confidence, faith and good-will in the hardship program.

77 Ms Catriona Lowe, *Submission 200*, paragraph 42.

78 Ms Catriona Lowe, *Submission 200*, paragraph 44.

Bendigo Bank

11.65 As noted in chapter 2, Great Southern Finance (GSF) was the financing arm of the Great Southern Group.[79] Bendigo and Adelaide Bank Limited purchased certain loans from GSF and provided certain loans directly to scheme members.[80]

Agreement with Great Southern Finance

11.66 Bendigo and Adelaide Bank provided Great Southern with funds to provide loans at prevailing commercial rates to investors in its MIS. Some loans were written by Great Southern Finance and others by ABL Nominees Pty Ltd, a subsidiary of the bank. Loans written by GSF were 'subsequently "sold" (or assigned) each year to the bank', which is how GSF funded the loans it wrote.[81]

11.67 Bendigo Bank outlined the history of its involvement in providing finance to investors in Great Southern. In 2001, the bank established a program with Great Southern to acquire loans originated by GSF. The loans were either acquired or funded by the bank or wholly owned subsidiaries of the bank, ABL Nominees P/L or ABL Custodians P/L, in their capacity as trustees of various securitisation trusts.

> The first tranche of loans was acquired in 2002. The funding program was formalised in 2004 by the bank and Great Southern companies executing a loan sale and servicing deed.
>
> The purpose of the deed was to establish arrangements to allow GSF to assign loans to the bank, or related entities, on an ongoing and structured basis. The deed set out the terms under which GSF would sell loans to the bank, or related entities, including the eligibility and pool criteria for the loans and the credit policies to be applied when approving each loan. The deed also appointed GSF as the servicer of the loans. In 2006, the deed was amended to allow the bank, or related entities, to advance loans direct to investors while also retaining the option to purchase loans.
>
> The bank, or related entities, funded or acquired 49 tranches of loans under the terms of the loan sale and servicing deed. The loans were generally purchased within a short period after GSF advanced the loans. All loans assigned to the bank, or related entities, were purchased at face value—that is, no loans were acquired at a discount.
>
> The loan deeds provided to borrowers made them aware that GSF may at any time assign or transfer a loan to another party. The loan application also informed borrowers that GSF may exchange information with parties involved in securitisation arrangements. [82]

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79 Clarke v Great Southern Finance Pty Ltd (recs & mgrs apptd) [2012] VSC 260 (20 June 2012), [3]–[5].

80 Javelin purchased certain other loans from GSF.

81 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [21].

82 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [12].

11.68 According to Bendigo and Adelaide Bank:

> The securitisation or assignment of the beneficial interest in loans has been a standard part of the lending and securitisation markets in Australia since the mid-1990s. The general convention is that borrowers are not notified of any assignment as there is no legal obligation to do so. This was the approach adopted by the bank and Great Southern under the loan sale and servicing deed.[83]

11.69 In a joint letter dated 30 April 2009, the bank and Great Southern advised borrowers that the servicing of the loans would transfer to the bank to allow Great Southern to concentrate on its core business.[84] Administrators were appointed to the Great Southern group of companies in May 2009.

11.70 A number of growers joined a class action to challenge the standing of the PDS attached to their Great Southern scheme. They claimed that the PDS contained misleading statements and as a result they suffered loss and damage and, further, GSF and Bendigo and Adelaide Bank, among others, were liable for their loss. The growers also followed advice to cease making repayments on their Great Southern loans. After protracted legal proceedings, the court found in favour of Bendigo and Adelaide Bank, which, in effect, meant that the borrowers with outstanding loans assigned to the bank were valid and enforceable. In December 2014, the court made orders for the approval of a Deed of Settlement, which meet strong resistance from some growers, who firmly believed that the bank should be held accountable for their loss.[85]

Bank's due diligence

11.71 Bendigo and Adelaide Bank told the committee that GSF processed all applications for finance on behalf of the bank based on the information provided by investors. It stated further:

> GSF provided representations and warranties to the bank that all loans approved and funded by or assigned to the bank, or a related entity, satisfied the credit policy and eligibility criteria established by the bank; in particular, that the net asset position of borrowers and their capacity to repay the loans satisfied the bank's policy and eligibility criteria. Any loan made that failed to satisfy the bank's requirements was not funded by or assigned to the bank, or a related entity.[86]

11.72 It should be noted that Bendigo and Adelaide Bank cited the findings of the court which described the bank as:

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83 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [12].

84 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [12].

85 See Deed of Settlement proposed by Liquidators, May 2014; and name withheld, *Submission 53*, p. 1.

86 Bendigo and Adelaide Bank, response to *Submissions 52*, *63*, *175* and *176*, p. [13].

> …an 'innocent third party' that established an arms-length commercial arrangement to provide loans to investors in Great Southern managed investment schemes or purchase loans from GSF.[87]

11.73 The committee takes particular note of Bendigo and Adelaide Bank's statement that:

> It is a fundamental tenet of any market economy that investors are entirely responsible for their own actions and investment decisions. Any suggestion that the bank should share the consequences of their investment decisions is ill-conceived. It undermines the whole principle behind the role of banks in the provision of capital to investors, business, and markets. It is apparent that the complainants were attracted by the upside potential of an aggressive, highly leveraged wealth creation strategy but were not prepared to accept the burden of the downside risk.[88]

11.74 The committee flatly rejects this assertion. It agrees that while investors must take reasonable steps to protect their interests and accept responsibility for their decisions, lenders must act prudently and responsibly when providing loans. Although not directly involved in arranging these full recourse loans, the committee believes that the lenders, in most case banks, were obliged to be diligent and responsible lenders ensuring that the loans to retail investors were serviceable and did not place investors in a parlous financial situation should the investment fail. Banks cannot outsource their responsible lending obligations to third parties such as the financing arm of an agribusiness MIS. A number of red flags should have alerted the banks to the potential for inappropriate lending—some investors would have struggled to meet an appropriate net tangible asset threshold, the very high loan to asset value (90 per cent of the value of the investment) and, the fact that the RE was both facilitating the loan and spending it'.[89] Both ANZ and Bendigo Bank and Adelaide indicated that they did monitor the activities of the finance companies' adherence to the banks' lending policies. The committee can only assume that in a number of cases, despite the banks' assurances, they did not carry out this function well. The banks were party to what can only be described as irresponsible lending.

Resolving difficulties with outstanding loans

11.75 Bendigo and Adelaide Bank informed the committee that it had not appointed an independent hardship advocate to assist clients experiencing hardship to reach agreement on their loans. Noting that the bank's focus was on building relationships directly with customers, it argued that:

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87 Bendigo and Adelaide Bank, response to *Submissions 52, 63, 175* and *176*, p. [17]

88 Bendigo and Adelaide Bank, response to *Submissions 52, 63, 175* and *176*, p. [14].

89 Name withheld, *Submission 94*, p. [3].

> To appoint a consumer advocate to mediate between the bank and our Great Southern borrowers would prevent the bank having a direct and constructive relationship with those customers.[90]

11.76 To liaise with borrowers undergoing financial hardship, the bank has a specialised team, with many years of experience in dealing with such cases. According to the bank, the team has in-depth knowledge and training in the financial and non-financial issues that affect borrowers. The bank explained further that it:

> …has established processes to manage applications for financial hardship that are built around a philosophy of working with customers to achieve satisfactory outcomes that reflect the circumstances of each borrower. The specialised team is best equipped to work directly with Great Southern borrowers to resolve the outstanding loans.
>
> Many borrowers engage lawyers, accountants, or other financial advisors to assist them to resolve their position with the bank. The bank also encourages borrowers to discuss their financial and personal circumstances with an independent financial counsellor to assist them to formulate proposals to resolve their position with the bank. Borrowers, therefore, have access to advocates to promote the interests of their clients.[91]

11.77 The committee notes the assurances provided by Bendigo and Adelaide Bank that they have their particular hardship program with a highly experienced and appropriately skilled and trained team to help resolve matters. The committee, however, is of the view that the bank should consider following KordaMentha/ANZ's lead in appointing an independent advocate. In this regard, the committee notes that the bank cannot outsource its responsibilities for allowing borrowers to enter into unsafe loans. Even though the bank was not directly involved in arranging the loans and can legally distance itself from them, ethically it owed a duty of care to borrowers. As such, the committee believes that the bank should extend to those borrowers special consideration and support the appointment of an independent advocate as a gesture of good will.

Recommendation 14

11.78 The committee recommends that Bendigo and Adelaide Bank support the appointment of an independent advocate to assist borrowers resolve their loan matters relating to Great Southern.

Pattern of poor lending practices

11.79 In its June 2014 report, the committee examined lending practices, particularly those involving 'low doc' loans, and was highly critical of the lending

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90 Bendigo and Adelaide Bank, answer to question on notice, hearing on 6 August 2015 (received 31 August 2015).

91 Bendigo and Adelaide Bank, answer to question on notice, hearing on 6 August 2015 (received 31 August 2015).

institutions. It noted that while the courts tended to accept that brokers were not agents of the banks (but agents of the borrower), the lending institutions did not come out of this period of lax lending practices blameless. The committee argued the banks and other lending institutions must have, or should have, been aware of the dubious practices employed by some of the brokers arranging loans but chose to ignore them. Moreover, in some cases, the lending institutions clearly failed not only to exercise the skill and care of a diligent and prudent banker but were negligent, even complicit, in misleading their customers. It should be noted that in its 2009 report on financial services and products, the Parliamentary Joint Committee on Corporations and Financial Services expressed some doubt about the degree to which banks acted 'ethically, appropriately, morally and prudently in their decisions to grant loans to some Storm customers'.[92]

11.80 The lending practices employed by some of those who provided finance to their retail clients to invest in MIS form part of this pattern of poor and irresponsible lending practices clearly identified in the committee's 2014 report. Indeed, the similarities are remarkable—that is: the banks absolving themselves from due diligence responsibilities, in effect outsourcing this core function. They paid no heed to an investor's ability to service the loan and turned a blind eye to high pressure selling techniques and misleading assurances by those arranging the loans, particularly about the risks attached to a recourse loan.

New credit laws

11.81 The *National Consumer Credit Protection Act 2009* (NCCP Act) was intended to address the regulatory issues and market problems prevalent before 2010 and to prevent the irresponsible lending practices that emerged between 2000 and 2008. Under the new credit laws, credit licensees must comply with the responsible lending conduct obligations in chapter 3 of the National Credit Act. If the credit contract or consumer lease is <u>unsuitable</u> for the consumer, then credit licensees must <u>not</u>:

- enter into a credit contract or consumer lease with a consumer;
- suggest a credit contract or consumer lease to a consumer; or
- assist a consumer to apply for a credit contract or consumer lease.[93]

11.82 These conduct obligations apply to credit providers—such as banks, credit unions and small amount lenders—and to finance companies, lessors under consumer leases and credit assistance providers such as mortgage and finance brokers. The legislation requires credit providers to make inquiries into whether the loan would meet the borrower's requirements and objectives. In other words, since the NCCP Act

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92 Cited in Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 5.60.

93 ASIC, *Credit licensing: Responsible lending conduct*, Regulatory Guide 209, September 2013, p. 4.

came into force in 2010, both lenders and brokers have 'a positive obligation to make inquiries into a borrower's financial situation (i.e. that the loan will not cause substantial hardship), and to verify that assessment'.[94]

11.83 It is important to note, however, that loans made for the purposes of investment (other than for investment in retail property) are not covered by the legislative protections of the Uniform Consumer Credit Code (UCCC) or new credit laws introduced in 2010.[95] As ASIC observed in respect of agribusiness MIS:

> The NCCP Act and National Credit Code (in Schedule 1 to the NCCP Act) only apply to contracts under which credit is provided to natural persons or strata corporations (consumers) and that is wholly or predominantly for personal, domestic or household purposes or to purchase, improve or refinance residential property for investment purposes. Investment by the debtor (other than investment in residential property) is not a personal, domestic or household purpose (see s5 of the National Credit Code).
>
> The licensing and responsible lending requirements in the NCCP Act therefore do not address problems in lending practices relating to the promotion of agribusiness schemes.[96]

11.84 Nonetheless, ASIC does have some authority over credit facilities that are financial products. It stated that loans for the purposes of investing in MIS are credit facilities that are financial products under the ASIC Act and, as such, ASIC does have some jurisdiction. This responsibility, however, is limited to administering broad standards of conduct, including prohibitions on unconscionable conduct, misleading and deceptive conduct, and undue harassment and coercion.[97] According to ASIC:

> The enforcement of these prohibitions depends on the particular facts and circumstances of individual cases. Findings that they have been breached tend to be specific to each case and rarely set a general rule or precedent. The conduct standards in the ASIC Act are therefore at best an imperfect tool for a regulator seeking to address systemic or widespread issues.[98]

11.85 As clearly demonstrated in the committee's 2014 report, these particular powers were woefully inadequate in quashing the growth of irresponsible lending

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94 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 6.9; Consumer Action Law Centre, *Additional Information 8*, p. 1 to the inquiry into the performance of the Australian Securities and Investments Commission. For non-ADIs, the responsible lending obligations came into effect on 1 July 2010 and for ADIs on 1 January 2011. Being banks and mutuals, ADIs had a pre-existing code of practice, which had a similar obligation.

95 *Submission 34*, paragraph 112.

96 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 9.

97 *Submission 34*, paragraph 113.

98 *Submission 34*, paragraph 115.

practices. For example, ASIC informed the committee that the law on unconscionable conduct continued to evolve, but:

> …the courts have set a high bar for establishing unconscionability, particularly for commercial transactions. A general power imbalance between the parties or a contract that favours one party more than the other is not sufficient to support a claim of unconscionable conduct.[99]

11.86 In 2013, Treasury consulted on proposals for the regulation of, among other things, lending for the purposes of investment. Indeed, the then government released a draft National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 for public consultation calling for submissions on the exposure draft by 1 March 2013. The proposed draft bill flagged the intention to introduce regulations governing credit contracts where credit was predominantly for, *inter alia*, investment purposes and rules aimed at better informing consumers and preventing them from entering into 'unsuitable protected investment credit contracts'.[100] ASIC noted, however, that the proposed reforms did not progress: that a final policy decision had not been made on these proposals.[101] In any event, it noted:

> …the reforms proposed in relation to investment lending may not have resulted in the application of responsible lending obligations in relation to loans for the purpose of investment in managed investment schemes operated by properly licensed Australian financial services licensees.[102]

11.87 Furthermore, Treasury advised that:

> Full coverage of investment lending would require a referral of legislative power from the States and Territories. At the moment, the Credit Act includes compulsory licensing and responsible lending obligations. The States and Territories have not proposed to extend these obligations to include investment lending.[103]

11.88 The committee notes observations from some borrowers that they unfairly assumed all the risk when taking out loans to fund their investment in MIS. In 2010, three researchers suggested that there may be merit in requiring loans by MIS

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99 *Submission 34*, paragraph 114.

100 National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, Exposure draft, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/Credit-Reform-Phase-2-Bill-2012 (accessed 23 September 2015).

101 *Submission 34*, paragraph 116. See Department of the Treasury, National Credit Reform, Enhancing confidence and fairness in Australia's credit law, Green Paper, July 2010, http://archive.treasury.gov.au/documents/1852/PDF/National_Credit_Reform_Green_Paper.pdf and National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, Exposure draft, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/Credit-Reform-Phase-2-Bill-2012 (accessed 23 September 2015).

102 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 9.

103 ASIC, answer to questions on notice, No. 3, 2 October 2015, p. 6.

operators or associates for investments in MIS schemes to be made on a 'non-recourse' basis only. This approach would mean that the security was 'only the returns on the project rather than the investor's other assets' and that the MIS operator-lender would assume part of the risk of poor project outcomes for such loan-financed investments. They argued that this arrangement would 'likely induce lower loan-investment maximum limits'. In their view, another solution could be 'to impose a legislative maximum loan-to-valuation ratio as suggested by central banks in response to losses on mortgage loans in the Global Financial Crisis'.[104]

Committee view

11.89 Investment lending has been instrumental in facilitating significant financial loss for retail investors who borrowed to invest in agribusiness MIS.[105] In the committee's view, the responsible obligations imposed on brokers and lenders through the new credit laws should apply equally to the promoters, advisers and lenders involved in providing funds for investment purposes. The committee has no desire to stifle funding for investment but to put an end to situations where retail investors unwittingly enter into unsuitable loan arrangements.

11.90 The committee is firmly of the view that an urgent need exists to reform the disclosure obligations on those providing credit advice and on lenders who provide funds to retail investors for recourse loans. Accordingly, the committee calls on the government to take steps to ensure that consumers are better informed about borrowing to invest and are more adequately protected from unsuitable investment credit contracts. The committee is particularly concerned about consumers being encouraged to take out recourse loans, which means that, in the case of default, the lender can target assets not used as loan collateral. Evidence presented to the committee shows that, in many cases, investors did not appreciate that if their investment failed to generate the anticipated returns or failed completely, they would need to meet repayments from other sources and could be at risk of losing their home.

11.91 The committee was also extremely troubled by the numerous accounts of growers signing over a power of attorney to their adviser to arrange and refinance loans. Clearly, there was a serious breakdown in communication with growers unaware not only of the risky investment venture but of the high risk loan agreement they entered. This weakness in the regulatory framework around credit laws needs to be remedied. The consultation process, which commenced with the release of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, would provide an ideal starting point for reform and clearly should include recourse loans for agribusiness MIS. The committee understands a referral of legislative power

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104 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 10, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

105 See, for example, following chapter, paragraphs 12.2–12.12.

from the states and territories would be required to bring investment lending under the UCCC.

Recommendation 15

11.92 The committee recommends that the government initiate discussions with the states and territories on taking measures that would lead to the introduction of national legislation that would bring credit provided predominantly for investment purposes, including recourse loans for agribusiness MIS, under the current responsible lending obligations. The provisions governing this new legislation would have two primary objectives in respect of retail investors:

- **oblige the credit provider (including finance companies, brokers and credit assistance providers) to exercise care, due diligence and prudence in providing or arranging credit for investment purposes; and**
- **ensure that the investor is fully aware of the loan arrangements and understands the consequences should the investment underperform or fail.**

Recommendation 16

11.93 The committee recommends that the government consider ways to ensure that borrowers are aware that they are taking out a recourse loan to finance their agribusiness MIS and also to examine the merits of imposing a legislative maximum loan-to-valuation limit on retail investors borrowing to invest in agribusiness MIS.

Recommendation 17

11.94 The committee recommends that the Banking Code of Conduct include an undertaking that banks adhere to responsible lending practices when providing finance to a retail investor to invest. This responsibility would apply when the lender is providing finance either directly or through a third entity such as a financing arm of a Responsible Entity.

Chapter 12

Class actions and legal advice to investors

> We entered into a Class Action with M & K [Macpherson+Kelley Lawyers], which again cost monies, and after about four years the Class Action lost. The original $133,000 loan has now been demanded from us at the cost of $245,000—with compounding interest.[1]

12.1 While the committee is of the view that the banks should have been more diligent and careful when providing finance for retail investors to fund their agribusiness venture, they cannot be held responsible for the actions of growers who followed legal advice to stop repayments on their loans. In this chapter, the committee considers the advice given to investors to cease repayments on their loans. Investors who followed this advice found themselves in a financial situation far worse than when the schemes initially collapsed.

Compound interest and mounting debt

12.2 Many investors saw their debts increase markedly from the time their scheme folded to the current time, in some cases more than double under what some described as 'crippling', 'exorbitant' and 'punitive' rates.[2] Compound interest meant that original loans grew substantially.[3] For example, one couple saw their loans from Timbercorp, which initially totalled between $200,000 and $300,000 accrue, and continue to accrue, with compounded interest, to nearly $700,000.[4] Similarly, Mr Wayne Grumley stated:

> I'm 53 years old and this was going to be my/our long term investment for retirement. I cannot see retirement for me in the near future, looks like I will [be] working until the day they put me in the ground. Now with the collapse of timber-corp, I'm left with a debt (originally $340,000) now

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1 Robert and Lynne Powell, *Submission 5*.

2 Ms Barbara Gray, *Submission 54*, p. 1; and Mr Mark Laszczuk, *Submission 157*, p. [1]. *Submissions 68*, p. [1]; *Submission 104*, p. 1; *Submission 131* and *Submission 153*, p. [2]. *Confidential Submissions 88*, 116, p. 1; *Confidential Submission 140*, p. 1; *Confidential Submission 155*.

3 *Confidential Submission 141*, p. 1.

4 Ms Barbara Gray, *Submission 54*, p. [1]; *Submission 55*, p. 1; *Submission 66*, p. 1; *Submission 72*, p. 1; *Submission 74*, p. 3; name withheld *Submission 96*, p. 1; *Submission 109*, p. 2; *Submission 110*, p. 1; *Submission 119*, p. [2]; *Confidential Submission 130*, p. 1. See also name withheld, *Submission 62*, p. 1—they owe $270,000 which is growing each month with a penalty interest rate of 13.2% from an initial $100,000 loan. Also *Confidential Submission 140 and Confidential Submission 141.*

> around the $600,000 and growing each month with a penalty interest rate of 13.2%.[5]

12.3 Many investors who saw their loans continue to mount were not making repayments.

Class action—advice not to repay

12.4 After the collapse of some of the major MIS, there were a number of prolonged class actions challenging the standing of the PDS attached to the respective MIS.[6] During this period, a number of submitters received and followed legal advice not to repay their loans.[7] For example, Bendigo and Adelaide Bank noted that after Great Southern was placed in administration, various law firms advised their clients to cease making payments on their loans, including the law firm representing the lead plaintiffs in the class actions and a law firm representing clients of Mr Steve Navra. It observed:

> …it is difficult to understand how the law firms had sufficient information to properly assess the merits of any claims available to borrowers so soon after the collapse of Great Southern. Navra [an adviser who recommended Great Southern] also advised his clients in lengthy 'blogs' that he intended to cease making payments on his Great Southern loans. The inference was that his clients should do the same.[8]

12.5 M+K Lawyers, in particular, represented 'several thousand investors' seeking remedies following the collapses of Timbercorp and Great Southern REs.[9] It explained that the primary focus of the class actions was to seek an order from the court that the loans were unenforceable as well as to obtain compensation for damages. The basis of their claim in May 2010 was that:

> …at the time our clients invested in the respective schemes, the responsible entity failed to disclose key information concerning its financial position, and as a result our clients have been misled into investing. They were

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5 *Submission 2*, p. 1.

6 Name withheld, *Submission 97*, p. [2]; name withheld, *Submission 94*, p. [1] and Mr Mark Laszczuk, *Submission 157*, p. [1]. *Confidential Submission 36*, p. [4];

7 See, for example, name withheld, *Submission 75*, p. [1]; Mr Con Solakidis, *Submission 119*, p. [2]; *Confidential Submission 124*, pp. 1–2. Mr Bernard Kelly, *Proof Committee Hansard*, 12 November 2014, p. 7.

8 Bendigo and Adelaide Bank, response to *Submissions 52, 63, 175* and *176*, dated 24 December 2014, p. [16].

9 According to M+K, as at 31 May 2010, it was acting for over 2,400 Timbercorp clients, with over 2,100 of these participating in the class action; and over 1,600 Great Southern investors. M+K submission to Consultation Paper 133: Agribusiness Managed Investment Schemes: Improving Disclosure for Retail Investors, 31 May 2010, paragraph 3.

> deprived of the opportunity to make an informed decision about whether or not to invest and whether or not to obtain finance in order to invest.[10]

12.6 As noted in chapter 9 and the previous chapter, the courts rejected the argument, which meant that the former members of the failed schemes, who had anticipated being released of their loan obligations, were obliged to repay their original loan and the compounding interest.[11] Thus, during the protracted class actions, the many investors who took advice not to repay their loans found that their initial debt had blown out considerably and was continuing to mount on a daily basis. The situation arose with both Timbercorp and Great Southern. As one such investor noted:

> The reason why we did not act quicker regarding this matter is that we were part of a class action that took 5 years to go through the courts and then no positive outcome and not to mention out of pocket legal costs for what, just for some judge to tell us tough luck and pay up.[12]

12.7 Another investor who ceased repayments stated:

> The banks who took over the loans from Great Southern are chasing us for double what is owed due to us stopping payment to pursue this matter via legal avenues (which has added to our already large debt).[13]

12.8 Mr Mazzucato, another grower who did not keep up his repayments, informed the committee:

> The next 5 years was the time of the McPherson and Kelly Class action against Timbercorp. I did not see that there was any point taking legal action against the financial planner until the class action had ended. Over the time of this court case, the debt had ballooned to over $175,000 due to the extortionate interest rate applied to the loan. I now have a debt that is unserviceable.[14]

12.9 Concerns about ever increasing debt were all too common. For example, in one case, an investor initially had a debt of $240,000 at the time of Timbercorp's collapse, which had climbed to around $445,000 by 2014 with 'bank interest escalating daily'.[15] One couple explained that in 2009 they were advised to cease repayments on their Timbercorp loans pending a favourable outcome from the class action. They stated:

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10 M+K submission to Consultation Paper 133: Agribusiness Managed Investment Schemes: Improving Disclosure for Retail Investors, 31 May 2010, paragraph 5.

11 See paragraphs 9.36–9.46 and 11.70.

12 Name withheld, *Submission 33*, p. [1].

13 Andigone Aguilar, *Submission 50*. See also, *Submission 44*, p. 1.

14 *Submission 40*, p. [2].

15 *Confidential Submission 37*, p. 2. Also Mr Mark Laszczuk, *Submission 157*.

> Unbelievably the legal action was unsuccessful and to add insult to injury our combined initial investment of $158,100 has since doubled to $355,000 due to highly unreasonable penalty interest that accrued.[16]

12.10 Yet another spoke of the legal proceedings dragging out for four or five years with initially the company and later the receiver continuing 'to stack on large amounts of interest to the borrower'.[17] Another couple recalled their story which replicates those of many others:

> Since the collapse of Timbercorp in April of 2009, 9 months after our initial investment, we've been unable to make sense and understand what went wrong. Our investment was gone, but where did the funds go? As a result, we joined a class action run by M&K Lawyers. Along the way, we received more bad advice, to stop paying the loans.
>
> …
>
> In April 2014, we have lost our legal battle, after one trial in the Supreme Court of Victoria, an appeal and a High Court dismissal. Unbelievably the loans have doubled from $178,570 to $326,998 due to highly unreasonable penalty interest that accrued. This is totally unrealistic for an investment. As we speak these loans are getting charged at 13.2% interest, when the market rate is around 5%. There is no income return that we will ever receive and this loan is not repayable over our lifetime given our age.[18]

12.11 ANZ was aware that M&K lawyers had provided advice to suspend payments during the class action involving Timbercorp. It advised that because ANZ did not provide the loans, which were under the management of KordaMentha, ANZ had 'no specific information on their status'. It was also of the view that it was 'inappropriate for ANZ to get between the lawyers and their clients'.[19] KordaMentha noted that the borrowers who stopped making repayments in breach of their obligations had interest accruing at the higher rate of interest 'in accordance with the terms of the loan agreements, which caused loan balances to increase ever since'. It stated:

> Timbercorp Finance has continued to provide annual loan statements to Borrowers. We submit that insofar as Borrowers have acted on advice to cease making loan repayments and have suffered loss and damage as a result, they should carefully consider claims which may be available to them against those that proffered the advice.[20]

12.12 With regard to Great Southern, Bendigo and Adelaide Bank noted that it wrote to borrowers on a number of occasions outlining the financial implications of ceasing to make repayments, in particular, the effect of compounding interest on the

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16 Name withheld, *Submission 75*, p. [1].

17 Name withheld, *Submission 94*, p. [1].

18 Name withheld, *Submission 102*, p. [1].

19 ANZ, answer to question on notice, No. 3, taken on 6 August 2015.

20 KordaMentha, additional Information, dated 4 December 2014, p. 2.

balance of their loan.[21] It informed the committee that 'compounding interest is a powerful tool for depositors, but it is debilitating for borrowers'.[22]

Committee view

12.13 The investors who took legal advice to cease their repayments are faced with a loan substantially greater than at the time their schemes collapsed. The committee is concerned that vulnerable people who joined the various class actions hoping to, in effect, have their loans deemed unenforceable are now in a financial position far worse than when the class actions started.

12.14 The committee is firmly of the view that the legal profession has the responsibility to inform itself of the circumstances around the advice that was provided to retail investors in collapsed agribusiness MIS to cease repayments on their outstanding debts. Accordingly, the committee contends that a review needs to take place to determine whether action should be taken to ensure that the profession maintains high ethical standards and that its members adhere to best interest obligations towards their clients.

Recommendation 18

12.15 The committee recommends that the Victorian Legal Services Commissioner and Legal Services Board thoroughly review the conduct of the lawyers who provided advice to retail investors in collapsed agribusiness MIS to cease repayments on outstanding debts and the circumstances around this advice.

12.16 The intention would be to determine whether the profession needs to take measures to ensure it maintains high ethical standards and that its members adhere to best interest obligations towards their clients. The investigation would include making recommendations or determinations on:

- **remedies available to investors belonging to the class actions who have suffered considerable financial loss as a result of following advice to cease repayments on their outstanding loans;**
- **whether disciplinary action should be taken against the lawyers who provided the advice to stop repayments;**
- **whether the matter warrants any form of compensation; and**
- **whether the matter should be referred to any appropriate disciplinary body.**

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21 Response from Bendigo and Adelaide Bank, dated 24 December 2014, p. [16].

22 Confidential correspondence to committee, dated 19 October 2014, p. [2].

Part III—MIS as a commercially viable model and their marketing to retail investors

There were many shortcomings in the promotion of MIS to retail investors from the financial advisers who gave poor advice, the promoters of the schemes who appeared to downplay the risks inherent in the investment, the research houses that rated the schemes and the unfortunate lending practices which left many growers deeply in debt.

In this part of the report, the committee turns its attention to the commercial viability of some of the schemes, the business model and possible structural flaws, including whether they were Ponzi-like enterprises. The committee seeks to determine whether such schemes should have been marketed to retail investors in the first place.

Chapter 13

Business model—commercial viability

13.1 To this point in the report, the committee has focused on the financial advice aspect of MIS and particularly on the adequacy of the disclosure regime. In this chapter, the committee is primarily concerned with the performance of the schemes and the reasons for their ultimate failure. It considers factors that may have undermined the commercial viability of MIS schemes including high upfront expenses and the management and performance of the schemes.

Reasons for collapses

13.2 Some of the major organisations that gave evidence during the committee's inquiry attributed the collapse of the high profile agribusiness MIS to a number of reasons including:

- the global financial crisis (GFC);
- the 2007 taxation announcement (The ATO's change of interpretation in 2008 of the taxation arrangement for investments in non-forestry agribusiness MIS meant that investors in such schemes would no longer be able to claim upfront deductions for their contributions to the MIS on the basis that the investor was not 'carrying on a business'. In 2008, the Federal Court found that expenses were not of a capital nature and were, indeed, allowable deductions incurred in carrying on a business. Some claim that the delay in settling the test case created uncertainty in the market);[1]
- prevailing weather conditions including drought; and
- commodity prices.[2]

13.3 On the GFC, KordaMentha informed the committee that the effect of the GFC, which severely limited the availability of funds from the capital markets, and the higher than expected operating costs contributed significantly to the working

1 The Hon Peter Dutton, Minister for Revenue and the Assistant Treasurer, Media release, No. 007, Tuesday, 6th February 2007, 'Non-Forestry Managed Investment Schemes', http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2007/007.htm&pageID=003&min=pcd&Year=&DocType=0 (accessed 21 November 2014). See Australian Forest Products Association, *Submission 126*, pp. 6–7.

2 See, for example, CPA, *Submission 142*, p. [1] and ANZ, *Submission 145*, paragraph 18. The ANZ referred to 'drought, a change in how some of these schemes were assessed by the Australian Tax Office (ATO) in 2007 (the ATO ruling was later overturned by the Courts), and the onset of the global financial crisis'.

capital shortfall facing the liquidators.[3] Many investors, however, were of the view that the GFC exposed inherent flaws in the structure of the schemes.

13.4 Notably, long before the MIS failures, people in the industry were raising concerns about the commercial robustness of the schemes. Looking back, many are now convinced that the schemes were flawed from the start. One investor stated:

> I suppose this outcome may not have been so hard to take mentally if there was a particular event that caused this outside of Timercorp's control but all of the evidence including Timbercorp's outsourced analysis on their structure pointed to the fact that it was a doomed company and investors would not see a return.[4]

13.5 From the committee's perspective, it is important to detail some of the concerns that were raised about the commercial viability of the MIS before their collapse because such assessments could not be interpreted with the benefit of hindsight. The committee has already touched on the poor performance of some schemes in the context of the discrepancy between expected yield rates given in prospectuses and PDSs and the actual poor returns. Importantly, however, below expected yields may also have signalled fundamental flaws in the business model and management of the schemes.

Schemes' performance

13.6 As early as the turn of the century concerns about the commercial soundness of MIS were surfacing. A 2000 report from the Rural Industries Research and Development Corporation (RIRDC), undertaken to assess the effect of public investment ventures largely tax-driven, noted two main risks associated with investment in agricultural investment ventures:

- investors may not receive the benefits as specified by the promoter—short-term taxation benefits are typically achieved by investors, but long-term capital gains or income are not; and
- the venture may collapse—cash flow problems are common among agricultural investment ventures, usually as a result of the promoter making inaccurate financial forecasts.[5]

13.7 After analysing 39 ventures, the study assessed the financial performance of most of these ventures as 'poor to average'. Among other things, it found:

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3 Additional information, KordaMentha, 4 December 2012, paragraphs 9 and 26.

4 Name withheld, *Submission 31*, p. [1].

5 See Tracy Bramwell and Peter Chudleigh, *The Impact of Tax Driven Financial Investment on New Industry Development*, A report for the Rural Industries Research and Development Corporation, RIRDC Publication No 00/14, RIRDC Project No AGT–3A, February 2000, p. 2, https://rirdc.infoservices.com.au/items/00-014, (accessed 5 December 2014).

- the physical performance (yields etc) for 19 ventures was rated with about 50 per cent of them rated very poorly—at least some physical output was achieved by most ventures;
- project management was assessed for 18 ventures, of which nearly 40 per cent were rated as being very poorly managed and the remainder as mainly satisfactorily managed; and
- the financial performance of 18 ventures was rated, with around 60 per cent rated as performing poorly financially—only three of 18 ventures were noted as performing at least satisfactorily.[6]

13.8 The committee reached similar conclusions about problems with overly optimistic projections. In its 2001 interim report on mass marketed tax effective schemes, the committee found that few schemes represented 'a good investment in the ordinary meaning of the term', and without the 'tax deductibility' factor, very few would have 'got off the ground'.[7]

13.9 Cornish Consultancy maintained that policy makers were well aware of the risks inherent in agribusiness MIS by 2006, yet, in its assessment, they 'chose not to close down these schemes', resulting in the tax payer and investors losing billions of dollars.[8] In 2005/06, two researchers found indications of plantations in some cases achieving growth rates—Mean Annual Increments—less than the rates suggested in the PDS for the hardwood plantation MIS. According to the research, in Victoria at least, there were 'identifiable instances of MIS plantations being established on land in rainfall areas of below 650mm p.a. which is the minimum feasible rainfall indicated in the PDS of the largest MIS operator'.[9]

13.10 Around the same time, researchers with RIRDC again questioned the commercial viability of some agribusiness MIS. They reported that along with other studies, their analysis suggested that the MIS sector (but not all MIS) continued 'to perform poorly with respect to realistic or actual rates of return versus projected

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6 Tracy Bramwell and Peter Chudleigh, *The Impact of Tax Driven Financial Investment on New Industry Development*, A report for the Rural Industries Research and Development Corporation, RIRDC Publication No 00/14, RIRDC Project No AGT–3A, February 2000, pp. 24–25.

7 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Interim report, June 2001, p. 2.

8 *Submission 60*, p. 3.

9 Patrick Mackarness and B Malcolm, 'Public policy and managed investment schemes for hardwood plantations', School of Agriculture and Food Systems, The University of Melbourne, *Extension Farming Systems Journal*, volume 2, No. 1, p. 106, https://www.csu.edu.au/__data/assets/pdf_file/0008/109547/EFS_Journal_v02_n01_10_Mackarness_and_Malcolm.pdf. One of their recommendations was to increase ASIC's powers and duties regarding agribusiness Product Disclosure Statements to include independent evaluation of MISs by experts who are not appointed by the Responsible Entity (see Lacey et al. 2006), p. 115.

rates'.[10] The researchers found that the performance of MIS could be expected to vary considerably, producing good and poor performers but it was likely that returns to investors would be 'less than satisfactory, with high commissions for marketing and profits to promoters being important factors'.[11] They argued:

> Product Rulings may have provided greater tax certainty for individual investors in projects but from the community's point of view, resources are wasted if investors are being encouraged to invest in non-commercial projects by optimistic forecasts and/or inadequate regulation. The beneficiaries, in these cases, are the promoters and managers.[12]

13.11 In its submission to the 2008 Review of Non-Forestry Managed Investment Schemes, the NFF referred to the RIRDC's suggestion that the overall MIS sector continued to perform poorly with respect to realistic or actual rates of return versus projected rates.[13]

13.12 Some submitters to this current inquiry also harboured serious doubts about the viability of agribusiness MIS well before their downfall. For example, CPA Australia informed the committee that it had long recognised the potential risks investors took when investing in agribusiness MIS. It indicated that it had been proactive in trying to ensure that investors were educated about the risks so that they could make informed decisions. For example, since early 2000 CPA Australia had issued a range of investor guidance, media articles and advertisements encouraging potential investors to seek professional advice on MIS before investing.[14]

13.13 Mr Tom Ellison noted that around 2004 when plantings and land acquisitions were at their peak:

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10 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture, with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. vii, https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

11 See, for example, Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 44, https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

12 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries,* Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 10, https://rirdc.infoservices.com.au/items/05-078 (accessed 5 December 2014).

13 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 4, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014).

14 *Submission 142*, p. [2].

> At the basic, fundamental economic level, paying three or four times the value of productive farmland to plant a commodity crop on should send warning bells, because commodities are low price and subject to huge variability and it is not normal to expect people to spend hundreds of millions of dollars buying land to facilitate that.[15]

13.14 Mr Sean Cadman from the Cadman and Norwood Environmental Consultancy suggested that when Timbercorp and Great Southern harvested their first plantations 'the unrealistic nature of the yield forecasts and returns to investors became apparent'. He argued that despite the disappointing results the schemes continued and additional changes to taxation arrangements 'actually made things worse'.[16]

13.15 Mr Samuel Paton, the Principal of Agribusiness Valuations Australia, indicated that in 2005 it was already clear to him that the structure of the schemes was 'doomed to fail and produce very poor outcomes for government (in terms of balance of payments offsets), investors, taxpayers etc'.[17]

13.16 Mr John Lawrence, an economist, tax accountant and more recently a public policy researcher, noted that one of the principal reasons for the failure was underperforming yields. He explained that 'the yields from crops planted over a 15-year period from 1994 were, on average, only about 60% of what was predicted by the respective PDS'. Mr Lawrence stated:

> Price increases failed to eventuate as predicted. Instead wood fibre followed the pattern experienced by every other bulk commodity over time where real price decreases are the norm.[18]

13.17 With regard to Great Southern, he noted that the projected yields for 55,000 hectares of trees from the 1998 to 2004 crops were predicted to be only 160 tonnes per hectare compared to the PDS predictions of 250 tonnes.[19] Referring to the suggestion that harvest yields could be reliably predicted after 4 years, he noted:

> If there was sufficient certainty that yields could be predicted after 4 years, enough to bring future commissions to account, the impending MIS crisis should have been obvious to insiders well before, particularly to foresters responsible for site selection. These same foresters however never wavered from their assessment that 250 tonnes was reasonably achievable despite overwhelming evidence to the contrary based on past actuals.[20]

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15 *Proof Committee Hansard*, 4 August 2015, p. 21.

16 *Submission 105*, p. [2].

17 *Submission 149*, p. 2.

18 *Submission 194*, p. 3

19 *Submission 194*, p. 5.

20 *Submission 194*, pp. 5–6.

13.18 In his words, the prediction 'was never downgraded despite repeated evidence to the contrary' and there was 'never enough suitable ground to grow what was promised'.[21] Importantly, he noted, however, that it was just not one project that fell short of expectations—'there was a consistent pattern'.[22] In summary, according to Mr Lawrence, MIS failed principally because they were 'duds'.[23]

13.19 According to a report tabled by Mr Peterson during a public hearing, returns from Timbercorp's 2006 and 2007 horticultural harvests were generally falling short of expectations.[24]

Poor management

13.20 In some cases, poor management was held to contribute to the disappointing performances. In 2011, the House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry expressed concern about the management of forestry MIS. At that time, a witness told the committee that the MIS regime had worked to put trees in the ground but not 'the right trees in the right ground' to meet actual needs.[25] A number of witnesses spoke of planting trees in the wrong locations—away from processing plants that did not allow 'leverage on existing infrastructure'. Others referred to planting the wrong species of tree.[26] As one witness stated:

> The MIS tax incentives drove a lot of money into plantations and it was like a gold rush. To get those trees in the ground by the end of June meant that the wrong species were planted in the wrong place at the wrong time. There was no prudent linkage to a productive outcome.[27]

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21 *Proof Committee Hansard*, 5 August 2015, p. 1.

22 *Proof Committee Hansard*, 5 August 2015, p. 11.

23 *Submission 194*, p. 3.

24 Kylie Mastores to Sol Rabinowicz, Robert Hance et al, email, 14 May 2007, tabled document, 12 November 2014.

25 Mr Nick Roberts, the Australian Forest Products Association, in House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees,* Inquiry into the future of the Australian Forestry Industry, November 2011, paragraph 5.47.

26 House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees,* Inquiry into the future of the Australian Forestry Industry, November 2011, pp. 70–71.

27 House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees,* Inquiry into the future of the Australian Forestry Industry, November 2011, p. 71. Councillor Lindsay Passfield, House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Committee Hansard*, 1 September 2011, p. 18.

13.21 Citing the House of Representative committee's inquiry into the future of the Australian Forestry Industry, the Department of Agriculture noted the concerns about the suitability of the plantations established under MIS. The department stated:

> There is evidence that some MIS plantations were established in less than optimal locations. For example, in a few instances, there appears to have been poor consideration of the suitability of the species to the growing location, as well as the proximity of the wood resource to suitable markets or processing facilities.[28]

13.22 Planting trees and crops in unsuitable locations does not make commercial sense, but the evidence strongly suggested that the use of tax incentives drove this type of decision-making and the schemes ended up very much supply rather than demand driven.

Tax incentive—driver of uncommercial decisions

13.23 Indeed, many commentators associated with the industry saw the failure of the MIS industry as 'in some ways a reflection of the inherent problem of using tax inducements to fund industry'.

13.24 A 2006 RIRDC study observed that investors were paying substantial premiums through MIS marketing commissions and profits to be able to claim taxation deductions for their investments in MIS.[29] In 2009, the PJC heard a number of complaints about the potentially market distorting effects of the tax incentives available to agribusiness MIS investors. Evidence suggested that rather than investment flowing to commercial activities on the basis of profitability, tax incentives had generated an influx of investment to agribusiness MIS that would have been directed elsewhere had they not been available. Such incentives created an inefficient use of capital and an uneven playing field for traditional agricultural enterprises competing for scarce land, water and labour resources.[30]

13.25 While the tax incentives may have diverted investment away from other sectors in the economy into agribusiness MIS, they also had the potential of skewing investment towards the front end of the schemes.

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28 *Submission 135*, p. 7.

29 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries,* Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 48.

30 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into aspects of agribusiness managed investment schemes*, September 2009, p. 17.

13.26 NewForests stated that the deductions became 'the goal', and the underlying investments 'a kind of by-product of the tax deduction'.[31] It stated further:

> While most of the MIS timber plantations in Australia were professionally established, the drive for land and planting deadlines pushed new plantations into areas of low rainfall, poor market access or areas of limited historical forestry experience. As MIS companies acquired extensive land banks with debt finance, the sector became overleveraged. The high costs of managing large numbers of retail clients, packaging and selling the products, and financing the whole cost base upfront, meant that the projects were commercially non-viable. So while the calamitous end of the MIS was unforeseen, many commentators felt it was overheated and due for some form of correction. Ultimately, the stress of the financial crisis led to a complete collapse of the industry.[32]

13.27 Evidence before this current inquiry similarly supported the contention that the tax deductions may have had unintended adverse consequences. The Tasmanian Farmers and Graziers Association (TFGA) noted that MIS generated investment was not based on sound long term strategic investment planning but primarily motivated by tax incentives, which caused significant distortions within the markets in which they operated.[33] The TFGA referred to the 'excessive haste' in implementing the schemes without any overlying strategy, which was executed in an ad hoc and detrimental way.[34] In its view, the MIS arrangements 'have clearly demonstrated that attempting to drive investment via tax incentives is a potentially risky strategy that often has unintended negative consequences'.[35]

13.28 Mr Richard Hooper, TFGA, informed the committee that the tax requirement encouraged a lot of forestry companies to 'get the money spent' and 'so they did unseasonal plantings and picked land that was never really suitable for trees'.[36] His colleague, Mr Nicholas Steel, acknowledged that the industry needed to attract capital and, while noting that MIS was a good tool, agreed with the view that the rules around it were not and had allowed the market to be distorted—'too many trees were planted, and planted in some of the wrong areas'.[37] Also, referring to the tax incentive, Mr Michael Hirst observed:

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31 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The changing Landscape of Australia's Forestry Investment Sector', p. 4, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

32 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The changing Landscape of Australia's Forestry Investment Sector', p. 4, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

33 *Submission 24*, p. 4.

34 *Submission 24*, p. 5.

35 *Submission 24*, p. 6.

36 *Proof Committee Hansard*, 5 August 2015, p. 16.

37 *Proof Committee Hansard*, 5 August 2015, p. 17.

> …as soon as you introduce the incentive to plant out as much as you can, because it emphasises the returns, you are going to run into problems because it entices greed and bad practices. So, in some manner, we have to have someone to say, 'No, the figures you quoted are not right,' or, 'No, that country is not suitable.' Maybe that is the way that there could be ethical planting, because, like I say, if you are doing it on commissions and on an amount of money per hectare, it is probably going to end in tears down the track.[38]

13.29 Similarly, Mr Lawrence drew attention to the effect of the tax incentives on decisions:

> Originally when managed investment scheme companies put out a product disclosure statement and they might have only planned to plant 5,000 hectares, they probably could have managed that. But there were a couple of peak years—2005–06 from memory—where sometimes they would be flooded with applications…I think in one instance one of the companies might have had over 20,000 hectares. There was a mad scramble for land, and that is when they started leasing land from farmers—increasingly so—because they had all this money and they could not hand it back. It was too good to be true, so they had to lease land from farmers.[39]

13.30 ASIC also noted that the availability of tax incentives for investment in forestry MIS 'may have encouraged levels of investment that may otherwise not have been achieved'.[40]

High upfront commissions and establishment costs

13.31 The poor performance may also be linked to the high upfront costs of the schemes that diverted funds away from the actual preparation for, and planting of, the trees or crops.

13.32 Earlier the committee referred to the high commissions paid to advisers. This practice not only had the potential to compromise the quality of advice but to reduce the funds available for the actual investment. Again, there were early warning signals of the risks that these high upfront expenses posed to the success of the schemes.

Early warnings

13.33 Well before the collapse of the major agribusiness MIS, commentators within the industry had voiced concerns about the tax incentive encouraging high upfront fees and other expenses and the effect on the commercial viability of agribusiness MIS. For example, such concerns were raised as early as 2001 during the committee's

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38 *Proof Committee Hansard*, 5 August 2015, p. 17.

39 *Proof Committee Hansard*, 5 August 2015, p. 8.

40 *Submission 34*, p. 11.

inquiry into tax effective schemes.[41] At that time, evidence before the committee noted, in regard to blue gum plantations, that some plantation companies charged investors an upfront fee in excess of over $9,090 per hectare. The Minority Report to the committee's final 2001 report observed that credible research from government agencies, such as the Department of Conservation and Land Management in Western Australia and academic departments such as ANU Forestry, showed that it should cost no more than about $3,000 (maximum) to establish one hectare of blue gums on leased land over a 10–12 year rotation period.[42]

13.34 Van Eyk, an investment research, advice and funds management company, told the committee in 2001 that it was inconceivable how any project, or any business, could expect to be successful when between 70 and 80 per cent of the funds invested were 'immediately diverted into what is basically non-productive expenditure'. It stated further that it was difficult to understand how 'both the ATO and ASIC rationalise such schemes to be "commercial ventures" on a pre-tax basis when such a high proportion of the funds are not in fact utilised in actually growing or producing the crop'.[43] In short, van Eyk argued that the majority of agribusiness schemes were likely to fail commercially because not enough of the funds raised were 'going into the ground'. It concluded that growers would 'gain no return on the investment and a potentially viable industry sector will be brought into disrepute'.[44]

13.35 At that time, witnesses from a range of agribusinesses disputed van Eyk's assessment. In particular, they rejected the claim that the agribusiness sector as a whole systematically overcharged for management fees and commissions. For example, Great Southern Plantations Ltd suggested that van Eyk did not sufficiently consider the whole life cycle of the businesses it criticised.[45] Mr John Young, then Chairman and Managing Director of Great Southern, said:

> They look at certain issues such as stumpage, which they have mentioned, and up-front establishment costs. What they do not look at is the long-term viability of the businesses, the cash flows and liquidity, the borrowing levels, the balance sheet, the whole box and dice. So we feel that their research is flawed in that regard…[46]

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41 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, 2002, Minority Report, paragraph 1.130.

42 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, 2002, Minority Report, paragraph 1.131.

43 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.52.

44 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.53.

45 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.55.

46 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.56.

13.36 Again in 2005/06, two researchers felt the need to highlight the fact that a substantial proportion of the initial investment in MIS went to activities other than the establishment costs of the plantation. They found:

> It costs around $1,600 per hectare to establish Blue Gums. This is a robust figure. The remaining $7,400 of the original $9,000 per hectare investment is devoted to other matters including prospectus costs, the purchase of land by the Responsible Entity, sometimes payments of commissions to the financial planners of the investors, and profit.[47]

13.37 In 2006, Mr David Cornish, then with MS&A, advisers to Australian agriculture, pointed to high upfront fees, noting:

> The promoters, such as Timbercorp and Great Southern, charge the investor (man in the street) substantial upfront fees to manage a timber lot on their behalf.[48]

13.38 In support of his argument, Mr Cornish cited evidence given by the ATO in 2001 to this committee, which suggested that 'in some cases the establishment and management fees may be artificially geared so that no matter what happens to the business itself, investors are guaranteed at least a 'tax profit' for their investment.[49] Moreover, he suggested that it was becoming obvious as the first schemes came to fruition that the actual returns were 'well below market expectation'.[50] According to Mr Cornish, the tax policies at the time meant that the promoter's profits were:

> …based purely on its ability to sell a scheme and capture upfront fees, not on how profitable that scheme is. **More importantly, the risk of failure of these schemes is jointly owned by the investor and the taxpayer. The promoter bears no financial risk if the project fails**.[51]

13.39 Mr Cornish argued that it was 'critical to understand that the investor only owns the trees'—that 'the promoter buys the land from the surplus generated from

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47 Patrick Mackarness and B Malcolm, 'Public policy and managed investment schemes for hardwood plantations', School of Agriculture and Food Systems, The University of Melbourne, *Extension Farming Systems Journal*, volume 2, number 1, p. 106.

48 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, pp. 1, 6 and 8.

49 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, p. 10 and Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.54.

50 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, p. 13.

51 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, pp. 7–8 (emphasis in original).

these massive upfront fees charged to other schemes'.[52] In 2006, he maintained that proposed policy changes must be able to resolve the current failures of the MIS industry. In his assessment, these failures were:

- profiteering by promoters at the expense of the Australian taxpayer;
- asymmetric information—due to the lack of credible independent and transparent information on the profitability of the project; and
- the promoters' lack of accountability to achieve profitable outcomes for their investor clients.[53]

13.40 Concerns about the commercial viability of these schemes persisted. In 2008, Adviser Edge, an investment research house, referred to a review of many MIS, which suggested that high profit margins were being earned by managers in initial years. By 'high' Adviser Edge meant that the profit margins in some cases were particularly excessive 'to indicate that profit margins had been brought forward from later years into the initial year of the MIS project'. Adviser Edge considered that this aspect of the MIS regime was potentially one that needed to be addressed. Its research indicated that:

> …on average, 42% of application fees were attributable to agricultural operational expenses in FY 2007/08. This includes all non-forestry MIS projects assessed by Adviser Edge in FY2007/08 for which managers provided a break-down of the application fee. The median percentage of application fees attributable to direct operational expenses is slightly higher, with a total of 45%. This implies that, on average, 58% of all application fees for non-forestry MIS was attributed to adviser commissions, marketing, product development costs, administration, corporate overheads and manager profits.[54]

13.41 Referring to the upfront expenditure, Adviser Edge noted that the costs associated with administration and product development of MIS projects and adviser commissions were substantial:

> MIS managers receive a significant proportion of their profits as part of the initial application fee. The heavy weighting on the application fee reduces

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52 Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', *Submission 60*, pp. 1 and 8.

53 *Submission 60*, p. 10 and Appendix one, 'MS&A submission on the proposed new taxation arrangements for investments in Forestry Managed Investment Schemes (MIS)', p. 19 in *Submission 60*.

54 Submission to the Review of Non-Forestry Managed Investment Schemes, p. 12, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

> the risk for the manager, and transfers the majority of production risk to the investor.[55]

13.42 Dr Judith Ajani submitted to the 2009 PJC's inquiry that an investigation of late 1990s hardwood plantation prospectus documents revealed a wide chasm between market outlook and actual market realities.[56] According to Dr Ajani:

> Before the MIS approach to growing wood, it cost around $2,000 to plant and manage a hectare of trees over a ten year rotation. Managed investment schemes more than quadrupled that cost. Neither wood prices nor plantation yields have increased anywhere near sufficient to offset this cost increase. The public purse is the biggest loser in this arrangement.[57]

13.43 Based on her research, Dr Ajani contended that far from being an attractive investment proposition, forestry MIS were 'never a commercially viable arrangement from the perspective of the so-called "investor"'.[58] The NFF informed the PJC that the decisions to invest in MIS were largely based on the tax deductibility of the investment rather than the promise of long term profitability. It argued that as a result of this measure:

> …MIS have traditionally been primarily focused on industries with a high proportion of up-front expenses, with little regard given to the output returns generated.[59]

13.44 The same concerns were repeated during this current inquiry. For example, Mr Bryant noted the high upfront fees including commissions paid to advisers (minimum ten per cent) and the salaries paid to the company's back room support staff. In regard to Timbercop, Mr Bryant noted that there were approximately 80 staff at its peak, a number of whom were on performance bonuses, which would take their six-figure base salaries even higher.[60] Mr Cornish, who had also registered his concerns in 2006, told the committee that:

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55 Submission to the Review of Non-Forestry Managed Investment Schemes, p. 12, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

56 Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into aspects of agribusiness managed investment schemes*, included in *Submission* 26, p. 56.

57 Submission to Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into aspects of agribusiness managed investment schemes*, included in *Submission* 26, p. 56.

58 *Submission 26*, p. 1.

59 NFF, *Submission 22* to the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS), *Inquiry into aspects of agribusiness managed investment schemes*, p. 3; and New South Wales Farmers' Association, *Submission 52* to the PJCCFS inquiry into agribusiness MIS, pp. 5–6. It noted that that the commercial decision to invest in MIS was 'based on the immediate tax deductibility of the investment, rather than any dividend return or the entity's long term profitability' and investors 'lured by this incentive have forced a rapid expansion in the MIS sector'.

60 *Proof Committee Hansard*, 12 November 2014, p. 12.

> …current taxation policy significantly reduces the likelihood of the investor receiving an economic return, rather than if the taxation advantage was not available. This is simply due to the promoter exploiting the tax benefit and charging the investor well above the cost of operation, and the investor accepting it, given he/she can write it off as a tax deduction.[61]

13.45 In his view, taxation policy to support the forestry industry should be 'adjusted to promote long term profitable timber production and efficiency within the industry'. He referred to the UK industry, where the tax incentive was removed from the upfront deduction to a tax break on the final product. In his assessment, such a measure would produce several favourable consequences that, *inter alia*, include:

- removing the ability for an MIS promoter to profiteer at the expense of the Australian taxpayer;
- making schemes profit focused—currently MIS promoters make money out of how many hectares they plant not on how profitable that is; and
- encouraging 'best practice' forestry to ensure profitability is maximised.[62]

13.46 Mr Lawrence was also critical of the corporate model. He explained that in most instances the deferred fee model was used with varying upfront payments combined with varying commissions at harvest time. He then noted that only a small portion was spent on tree establishment with much of the remainder lent by the RE to the parent company. He also drew attention to:

- the ongoing costs, which required funds from the parent and, because they were greater than expected, generated cash flow problems;[63]
- the requirement for new sales to replenish the cash tin; and
- the back up cash inflow, which came from so called annuity income from growers repaying loans, but the increasing loan defaults over time resulted in a slowing of the cash inflow.

Overall, in his view, the model was 'vulnerable'.[64]

61 *Submission 60*, p. 11.

62 *Submission 60*, p. 11.

63 According to Mr Lawrence, 'The underestimation of ongoing costs was highlighted when Gunns assumed management of Great Southern's MISs. The constitutions for each scheme were amended to increase the harvest commission by approximately 5% points for each estimated year until harvest. In other words, the newest project due to be harvested in 9 years time ended up with a harvest commission of over 50%. Growers can't make money on that basis'.

64 *Submission 194*, pp. 3–4.

Ponzi-like schemes

13.47 On reflection, some in the industry were of the view that the failure of some MIS was inevitable. In 2010, researchers from the Department of Finance, University of Melbourne, referred to Great Southern's decision 'to effectively ex post underwrite projected returns to investors in early schemes'. In their view, while this measure certainly placed the interests of the earlier investors first, it did so at the expense of those in later schemes.[65] They maintained:

> In principle, as long as the final year inflows are adequate, any combination of sources of funds is acceptable, and the lowest cost funding would appear optimal. However, if the approach used is that of creating new MIS to not only fund expenses of, but also provide unwarranted returns to, investors in earlier schemes, the structure has, at least, the appearance of a Ponzi scheme. Any subsidization of returns to investors in old schemes, motivated perhaps by a need to point to past investors returns to generate new interest, is not only inconsistent with the principle of scheme investors bearing the risk of their investment but exacerbates the risk of the RE becoming dependent on increasing growth in new MIS for survival. While not a Ponzi scheme per se, if promised returns to new scheme members are excessive, and returns provided to old scheme members are inflated relative to actual underlying returns, a Ponzi outcome of collapse is likely.[66]

13.48 The researchers explained further the effects of a company operating multiple schemes established at different points in time. In their assessment, using Great Southern as an example, two significant consequences flowed from this setup:

- The assets of any individual MIS are not fully quarantined and so are available for use in other schemes. The MIS investor has 'ownership' of a particular lot of trees or other plants, established when the scheme is set up. But the residual funds are deposited with the parent company GSL and thus, as a claim on the company's assets, co-mingled with those of other MIS (and other creditors) on the parent company. Indeed, GSL's revenue was dominated by new MIS subscriptions.
- Because the GSL business model was built on continuing and increasing creation of new MIS for a revenue stream and finance source, problems of attracting new investors could arise if returns on existing/maturing schemes were inadequate. Hence, incentives may have existed for GSL (or a subsidiary), as purchaser of harvests (for on-sale), to apply some new

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65 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 9, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

66 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 5. http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

investment inflows to subsidize returns to poorly performing old schemes in a 'quasi'-Ponzi' type structure.[67]

13.49 Some submitters shared this view that agribusiness MIS had the hallmarks of a Ponzi scheme. One financial adviser, who also questioned the viability and integrity of the schemes, stated that it was well known that many of the projects failed to perform to prospectus forecasts. To his mind, it appeared that there was no delineation of projects from one another with the result that in terms of cash flow:

> …the good subsidised the bad and the current subsidised the past.[68]

13.50 Arguably, in his opinion, the company was trading while insolvent.[69] Mr Cornish explained the Ponzi-like arrangement another way:

> The reality is that the whole structure of the business model of the promoter was based on getting that lump sum principal up top, and not how much money they make. The viability of Great Southern, Timbercorp and all those companies fell over when they could no longer get the next person into the scheme.[70]

13.51 Only after the collapses, did investors come to suspect that later schemes may well have been augmenting the returns of earlier underperforming ones. Mr David Lorimer spoke of being unaware that the funds he invested in one scheme were being used to prop up other schemes. In his words:

> This screams Ponzi scheme to me. I was always under the impression that each project was stand alone. I was obviously mistaken. (This point alone would have warned me off the schemes).[71]

13.52 One couple stated that the product disclosure statements/prospectuses highlighted individual project returns, which suggested that each project was independent. They argued, however, that in reality, 'if one project failed, this deficit would flow over and affect the profitable projects'.[72] In their words:

> We were also not aware that with this flawed business model, the viability of **OUR PROJECTS** was dependent on subsequent year's projects

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67 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January, 2010, p. 7, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

68 Name withheld, *Submission 106*, p. 2. See, also, name withheld, *Supplementary Submission 52.1*, p. [1].

69 Name withheld, *Submission 106*, p. 2.

70 *Proof Committee Hansard*, 4 August 2015, p. 14.

71 *Submission 55*. See, also, name withheld, *Submission 97*, p. [2].

72 *Confidential Submission 36*, p. [4].

> attracting sufficient investments. If not, then our yearly funds would be directed to propping up other projects and keeping them above water.[73]

13.53 Supporting this view, one grower stated simply that the financial decision to use money from later projects to finance earlier ones was 'bad financial management and hence undermined the later projects'.[74] Another suggested that Timbercorp Forestry appeared to be a vehicle created to generate revenue for Timbercorp where the real money was in finance and commissions. In other words, the MIS was 'a scam not a scheme for investors'.[75] A submitter, who wanted his name withheld, shared this same conviction. He argued that, in effect, the directors were looking at ways to minimize 'harm to the sales of woodlots in the 2005 project by covering for the returns to investors in the 1994 project'. Put another way:

> …funds from the new investments were required to top up some of the early investments as the yields were not as advertised in the PDS. These reduced yields were never ever communicated to prospective investors in the 2005 and 2006 schemes. In the end approximately 18,480 investors bought into the two schemes, some made cash investments some borrowed to invest. Little did they know that their funds were going to be used to top up earlier projects and thus start the downward spiral.[76]

13.54 Convinced that funds were being funnelled to prop up earlier projects, he asked, was this not 'the modus operandi of a Ponzi scheme?'[77] Mr Mazzucato agreed, stating that from all appearance, Timbercorp was operating a Ponzi scheme. Put simply:

> The profits of the business did not cover the costs to the business. They required new investors to pay their obligations to their older investors.[78]

13.55 In his estimation, the financial planners and banks treated this 'as a feeding frenzy preying on unsuspecting and unsophisticated investors'.[79] Another couple stated:

> There was evidence that Great Southern was effectively a Ponzi scheme whereby new investors were providing returns to old, plus there were financial reports showing Great Southern was actually insolvent when the last lot of 2008 Grapevines were sold. Two of the directors had resigned in 2006 following the surfacing of such Ponzi scheme information.[80]

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73 *Confidential Submission 36*, p. [4] (emphasis in original).

74 *Confidential Submission 140*, p. 2.

75 Name withheld, *Submission 41*, p. 3.

76 Name withheld, *Submission 150*, p. [1].

77 Name withheld, *Submission 150*, p. [2].

78 Mr Peter Mazzucato, *Submission 40*, p. [2].

79 Mr Peter Mazzucato, *Submission 40*, p. [3].

80 Name withheld, *Submission 56*, pp. [3]–[4].

13.56 Also referring to Great Southern, Mr Lawrence noted:

> Great Southern propped up the returns of the first three crops that were harvested. They interposed a related entity to buy the crop at an inflated price so that the growers would end up with the return they promised. But, of the first crop Great Southern grew, they harvested only 123 tonnes when 250 was predicted. The next two were not as bad but they were well below predictions, and they kept it under double wraps.[81]

13.57 In his opinion, had the company not bolstered the returns of its early schemes from 2005 until 2007 and had people been more aware of the yields, then the schemes would have 'fallen over a lot earlier than they did'.[82]

13.58 Mr Michael Galvin, who was Counsel for the plaintiffs in the Great Southern proceedings, also commented on the subsidisation of earlier projects. He referred to Great Southern's efforts to conceal the fact that its wood lots from earlier schemes were not going to produce anywhere near the predicted 250 cubic metres per hectare and therefore not produce the anticipated returns for growers. He cited the first forestry project, the 1994 eucalypt project, which was due for harvest in 2004:

> When it became apparent that the yield from this project would fall well short of the expected yield, rather than declare that outcome to the market and suffer the adverse publicity, the management of Great Southern implemented a transaction by which a newly-formed entity—Great Southern Export Company—purchased the woodchips at an inflated price equal to the amount which would have been paid had the yield been as anticipated to investors.
>
> Plainly, the volume of yields in earlier projects was likely to have a direct impact on sales in new forestry projects. It was not in the interests of Great Southern's ongoing schemes and business for the investors in the '94 project to receive a return which was substantially less than had been anticipated. When it came to his attention, non-executive director Jeffrey Mews was troubled by the apparent use of Great Southern's own money to top up returns to the '94 project growers. He ultimately resigned over the issue. Similar topping-up of the '95 and '96 project returns occurred, though a lesser sum was paid to growers in the latter project.[83]

13.59 In his words, Great Southern was 'putting off the inevitable'.[84]

13.60 Many who invested in the later schemes were surprised to learn that their funds were not being used to plant their vines or trees and had 'no prospect of

81 *Proof Committee Hansard*, 5 August 2015, p. 10.

82 *Proof Committee Hansard*, 5 August 2015, p. 1.

83 *Proof Committee Hansard*, 6 August 2015, p. 30.

84 *Proof Committee Hansard*, 6 August 2015, p. 32.

producing an income to repay loans'.[85] This was particularly evident to growers who were encouraged to invest in 2008 just before Timbercorp's fall. As one grower stated:

> I invested mid to late 2008 which was shortly before the complete collapse of the company when they knew that this was inevitable but continued to dupe individuals into investing based on their lies.[86]

13.61 A couple in their mid 60s were advised to invest in Timbercorp in June 2008 and by April 2009 it was in liquidation. In their view, they should not have to pay back their loan as they were sold the investment 'when the company was in difficulties'.[87] Along the same lines, Miles and Marion Blackwell were convinced that, although Timbercorp took their money, their trees were never planted. They also labelled the scheme 'a scam' meant to draw in more investors to help pay out the earlier ones.[88]

13.62 An older couple stated that they had received nothing for their investments in 2006, 2007 and 2008, indicating further that in 2008 'the trees were never even planted'.[89] Yet another grower stated:

> I struggle to understand how a company can advertise an investment with great return, then before there is even a crop in the ground the whole project defaults but they still charge an annual management fee and interest charges on a project that did not even exist. Timbercorp sold something to people, they could not deliver the goods, so I see no reason why we should have to pay for something that does not exist.[90]

13.63 Investors who invested in Great Southern just before the company collapsed gave similar accounts. With the benefit of hindsight, they also formed the view that the schemes were flawed from the beginning, with some suggesting that it was a Ponzi scheme which engaged in 'unethical, unconscionable conduct'.[91] One such investor remarked:

> By purchasing some of the last vinelots in 2008 we may never know if our grapes were actually planted or not, but the MIS as a whole was destined to fail. GS was operating a Ponzi-like scheme, providing loans to investors and using money (provided by Bendigo Bank) to continue trading and selling schemes while never actually developing or in some cases even

85 Name withheld, *Submission 91*, p. [2].

86 Name withheld, *Submission 31*, p. [1].

87 Name withheld, *Submission 48*.

88 *Submission 173*.

89 Peter and Elaine Wilson, *Submission 49*.

90 Name withheld, *Submission 77*.

91 Name withheld, *Submission 52*, p. [1].

> planting the vinelots. It now seems that GS had sold such a loan to us and transferred it to Bendigo Bank just prior to its collapse.[92]

13.64 Two growers who also held positions in Timbercorp are well placed to shed some light on the extent to which the companies relied on new investors to keep earlier schemes afloat. Mr Bryant was one of growers who likened MIS to Ponzi schemes.[93] To his mind, the problems stemmed from the manner in which the products were sold, explaining:

> The corporate structures were built on revenue streams that relied wholly on investor income at the front end. No other revenue would come to that entity until they got a proportion of harvest proceeds at the back end. Both those arrangements are commercially acceptable but it is the amount of money that went to getting these products into the market, which was not covered by anything other than investors' money.[94]

13.65 According to Mr Bryant, Timbercorp and Great Southern's single, upfront payment model meant that if you paid $3,000 for a wood lot:

> …the money went into the company. There was no portion of that put aside for future maintenance of the plantation in the case of timber lots. When the music stopped there was no money left to continue the plantations to the end.[95]

13.66 Mr Byrant's reasoned that this reliance on a form of revenue, where the company depended on investors' money going into the project, was 'basically akin to a Ponzi scheme'.[96] He agreed that the signs of Timbercorp's failure were there and referred to revenue streams and the need to continue to attract increasing sales. In reference to Timbercorp, he observed:

> They were getting decreasing sales before the GFC happened. They had to achieve the yields on the crops to get the revenue streams that they had budgeted on getting and they needed the recipients of loans to keep paying the loans. Those three things were not happening. The yields were not happening; they were not getting increasing sales—they were getting decreasing sales; and they were getting an increasing number of people defaulting on their loans. So it would have still happened.[97]

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92 Name withheld, *Submission 91*, p. [1].

93 Mr Andrew Reibelt, *Submission 104*; name withheld, *Submission 150*, p.[1]; name withheld, *Submission 153*, p.[2]; Mr Mark Laszczuk, *Submission 157*; name withheld, *Submission* 167, p. [5].

94 *Proof Committee Hansard*, 12 November 2014, p. 11.

95 *Proof Committee Hansard*, 12 November 2014, p. 11.

96 *Proof Committee Hansard*, 12 November 2014, p. 11.

97 *Proof Committee Hansard*, 12 November 2014, p. 28.

13.67 Mr Peterson explained further that Timbercorp made its money through annuity style income, which included annual rent, management fees, percentage share of crop, interest on grower loans and other. He noted that at its height Timbercorp's loan book was half a billion dollars. He surmised that if Timbercorp were making three per cent on money they borrowed from ANZ, the amount would be substantial. In his opinion:

> The loan book, as with Great Southern, was a very, very important revenue driver of the business.[98]

13.68 According to Mr Peterson, however, in February 2007 the Timbercorp default loan book, or loans in arrears—growers not paying their loans—was a sizeable $24.5 million but on 12 July, five months later, it had doubled to $49 million.[99] Mr Peterson drew together all the warning signs emanating from Timbercorp—projects not performing to expectations; fall in annuity revenue; the shrinking loan book; and the loans in arrears.[100] According to Mr Peterson, Timbercorp was in real trouble without being able to sell annuity products in horticulture.[101] He contended:

> If the projects were not on track and you had used a cash flow to get there to build your investment model, you were in real trouble. Timbercorp did not give out adjusted cash flows on an annual basis to take into account these results for clients already in projects. So when the clients started seeing these results and emailing us asking what is going on, they realised they could not afford to keep on paying the project, that they had been misled in their view, and the default loan book increases but, worse for Timbercorp, growers were saying: 'We don't want to invest in anymore projects…That was reflected in 2008 when only $119 million of product was sold, but by that stage the wheels were off—projects were not delivering, there was pressure from the financiers, the government was saying, 'No more MIS.…It was clear what was happening in February 2008—you were in real trouble…these projects were not delivering, growers were in default and annuity income was in trouble. What was going to keep the company afloat?[102]

13.69 Noting that no projects were being sold in 2009, Mr Peterson asked, 'where was the income coming from to feed this beast?'[103]

13.70 No one disputed the proposition that the earlier schemes had failed to perform as expected. In 2007, Australian Agribusiness Group (AAG) produced the results of its research, which reported that Great Southern had completed harvests from its 1994

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98 *Proof Committee Hansard*, 12 November 2014, p. 14.

99 *Proof Committee Hansard*, 12 November 2014, p. 15.

100 *Proof Committee Hansard*, 12 November 2014, pp. 17–19.

101 *Proof Committee Hansard*, 12 November 2014, p. 18.

102 *Proof Committee Hansard*, 12 November 2014, p. 19.

103 *Proof Committee Hansard*, 12 November 2014, p. 28.

and 1995 plantation projects achieving harvest volumes of 123 m^3/ha and 166 m^3/ha respectively. At that time, Great Southern advised that the lower than forecast yields were due to silvicultural issues, 'largely caused by specific site issues combined with below average rainfall conditions'.[104]

13.71 According to AAG's 2007 research report, Great Southern had, overtime, taken substantial action to address the problem of low yields, including better land selection, silvicultural practices and genetic improvements. It wrote that Great Southern believed firmly that the prices likely to be achieved for the projects due to be harvested over the coming few years were 'on track' to meet expectations.[105]

13.72 Hearing the Great Southern proceedings, Justice Croft also understood that in the ten years or so since the establishment of the 1994 plantations there had been a pronounced evolution in knowledge and experience in the forestry industry generally and in particular within Great Southern. According to Justice Croft:

> Much more was known empirically about the synergies and effects of soil depth, soil quality and annual rainfall on plantation growth. Consequently, in 2005 when Great Southern came to assess the productive capabilities of the land used in the 1994 plantations, those lands scored roughly half of the 250/m^3 they had originally been assessed at in 1994. I accept that the disparity between these 'scores' is a ready reflection of the significant evolution in the sophistication of plantation establishment and maintenance that had occurred during the decade or so since the 1994 plantations were established.[106]

13.73 Mr Galvin, who was Counsel for the plaintiffs in the Great Southern proceedings, had a different interpretation:

> I think, His Honour Justice Croft formed the view that there was a sufficient basis for distinguishing the earlier projects from the later projects, having regard to the improvements in silvicultural practices and seedling genetics. That is a view that would be open to debate, and was debated before His Honour. Ultimately, he determined that issue in favour of the defendants.
>
> Having said that, the evidence as I saw it was plainly that, if anything, the expected volumes were decreasing because the quality of the land that was being acquired for later projects was lesser. Land was becoming scarcer and

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104 Australian Agribusiness Group, *Great Southern 2008 Diversified Olive Income Project Retail Investment Research*, May 2007, updated July 2007, pp. B6–B7, https://www.accounting.eknowhow.com/johngrindal/files/0K9ZHF3I2K/AAG%20Research%20-%20Olives.pdf (7 September 2015).

105 Australian Agribusiness Group, *Great Southern 2008 Diversified Olive Income Project Retail Investment Research*, May 2007, updated July 2007, p. B7, https://www.accounting.eknowhow.com/johngrindal/files/0K9ZHF3I2K/AAG%20Research%20-%20Olives.pdf (7 September 2015).

106 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [36]–[37] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

it was becoming far more expensive. They simply could not get the land they needed to meet the estimates that they had been promoting.[107]

13.74 Evidence before the committee strongly suggests that during the peak years of investment in agribusiness MIS, the need to spend money and the subsequent drive for land meant that increasingly land with poorer soils and lower rainfalls were being selected. Other management decisions such as planting the wrong species would likewise affect productivity. Also, given the high upfront costs—commissions, marketing, administration and corporate overheads—the revenue from new schemes may well have been a critical element in maintaining the earlier schemes.

13.75 In 2009, ASIC reasoned that, while agribusiness MIS did not share the characteristics of a Ponzi scheme, a business model that relied on receipts from application fees for revenue 'may be unstable if the flow of new MIS sales is interrupted'.[108] Reflecting on the commercial viability of these schemes, ASIC, more recently, informed the committee that:

> The collapse of a number of responsible entities of forestry schemes has highlighted issues with this type of investment and the way forestry schemes were promoted to investors. While a small number of responsible entities are still operating in this space, they do not appear to be reliant on the sale of managed investment schemes to fund their business operations in the same way as responsible entities such as Timbercorp Securities Limited and others.[109]

13.76 In ASIC's estimation:

> Where a responsible entity of a forestry scheme is reliant on scheme sales for a substantial part of revenue for working capital, an interruption to scheme sales revenue could have significant implications for the responsible entity, and its ability to fulfil its contractual obligations owed to growers. We have seen that where scheme sales reduce suddenly, some responsible entities have not had sufficient reserves to fulfil their obligations to growers.[110]

13.77 Interestingly, in respect of the commercial soundness of MIS, Justice Judd found in December 2010 that:

> Wherever ultimate responsibility for the collapses may reside, it is difficult to overlook structural flaws in the design and regulation of managed investment schemes. These flaws facilitated investment strategies, management practices and decisions, regulatory attitudes and revenue

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107 *Proof Committee Hansard*, 6 August 2015, pp. 32–33.

108 ASIC, Submission to the Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into Agribusiness Managed Investment Schemes*, July 2009, paragraphs 89–90.

109 *Submission 34*, paragraph 9.

110 *Submission 34*, paragraph 53.

> policies which together conspired to cause huge financial loss to investors, the revenue, banks and other financial institutions, and the communities in which the schemes were operated.
>
> Whenever an enterprise is designed and structured to depend upon third party financing of 'tax effective' investment as its primary source of revenue, failure is almost inevitable. The generation of such revenue can become the substitute business, with the primary production activity a mere adjunct, undertaken in order to satisfy criteria for the deductibility of invested funds. Such managed investment schemes should not be mistaken for real businesses.[111]

13.78 As noted earlier, investors assumed that their funds were to be used for their particular scheme, but this was not necessarily the case where the RE operated a number of MIS. A reliance on new schemes to subsidise, or in effect underwrite, earlier schemes where performance was below expectations showed a clear weakness in the MIS model. This arrangement not only exposed the MIS to cash flow problems and eventual failure but was inherently unfair to the newer investors whose interests were compromised by preferring the interests of earlier investors—not all investors were being treated equally.

Conclusion

13.79 There was not one single cause that led to the collapse of some high profile agribusiness MIS. A range of factors combined that made some of these schemes a high risk venture and prone to failure. They included high upfront costs—generous commissions to financial advisers, funds diverted from operation expenses into the general working capital of the parent company, excessive overspending on corporate overheads and marketing—poor management decisions regarding the planting and location of the schemes, a business structure that depended on new sales for cash flow, and the lag time between initial investment and dividends.

13.80 There is a compelling argument that such schemes should not have been marketed to retail investors. The committee finds it difficult to justify the expenses involved in some but not all schemes—overspending on commissions, administration and marketing. Indeed, it would appear that investors paid way too much for their agribusiness plot and too little of their initial outlay went on productive expenditure. Also, despite the suggested improvements in silvicultural practices and seedling genetics, the discrepancy between the projected rates of return and the actual yields cannot be ignored.

13.81 In the following chapter, the committee looks at the marketing and selling of high risk products to retail investors.

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111 Environinvest Ltd (No 4) [2010] VSC 549 (8 December 2010) [2]–[3]. Environinvest was an unlisted public company that promoted and managed investment schemes, including the establishment and management of eucalyptus plantations, in which members of the public were invited to participate.

Chapter 14

Unsafe products

> Why are these products being allowed to be offered at a retail level to the person in the street?…the risk involved in agricultural investment is simply outside the grasp of your average person in the street.[1]

14.1 In Australia, the conduct and disclosure regulatory regime for financial products does not rely on merit regulation, but focuses on 'the transparency of the sales process (through disclosure) and the conduct of the intermediaries involved in the sale'.[2] Based on a strong tradition, this approach means that regulations governing disclosure and conduct are generally not concerned with the substantive 'safety' or quality of a financial product and its associated services. According to ASIC, this reliance on transparency in disclosure documents was premised on the general acceptance that 'consumers must take on some level of risk for investment products'.[3]

14.2 Evidence before the committee raised a number of matters that question the overall effectiveness of this regulatory regime in protecting the interests of retail investors. In respect of MIS, they included: the adequacy of disclosure so that the investors were able to comprehend fully the risks of investing and, notwithstanding robust disclosure requirement, whether such complex products should have been marketed to retail investors in the first place.

14.3 Also, the arrangements for borrowing to invest were an important part of the overall investment package and consideration must be given to the appropriateness of these lending arrangements for retail investors. In this chapter, the committee considers the marketing of these complex and high risk products to retail investors and the financing arrangements that allowed growers to borrow to invest.

Promoting and selling complex financial products

14.4 The committee accepts that investment carries risk: that from time to time some investments will not produce the expected returns or simply fail. But some investments by their very nature are high risk.

14.5 In its June 2014 report on the performance of ASIC, the committee discussed some of the implications of the low levels of financial literacy in Australia. It noted that when this is combined with Australia's current disclosure-based regulatory approach, retail investors and consumers may be further disadvantaged when deciding on a financial product. In this context, the Consumer Action Law Centre cited a

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1 Mr David Cornish, *Proof Committee Hansard*, 4 August 2015, p. 13.

2 ASIC, *Submission 34*, paragraphs 6 and 34.

3 *Submission 34*, paragraphs 6 and 34.

number of further complicating factors that pose a risk to the consumer. These included:

- extremely complex credit and financial products that non-experts would frequently misunderstand (including even the most important elements);
- people not necessarily choosing between products 'rationally', instead making quick decisions using mental shortcuts when dealing with unfamiliar topics or when limited by time; and
- people typically having trouble calculating costs and risks, especially when the cost or risk is temporally remote.[4]

14.6 These additional risk factors were present in abundance with regard to agribusiness MIS. The FPA described these schemes as 'particularly complex' products…'at the higher end of the risk spectrum' and 'with a 'particularly complex financing arrangement'. It noted:

> Many of our members have related to us that forestry and agribusiness MIS are so difficult to understand and justify as an investment option over alternative products that their licensees do not include them on their approved product lists and financial planners avoid them. Professional indemnity insurers likewise have begun to exclude such products from their policies, as a response to the perceived risk and opacity of the investment case for MIS recommendations.[5]

14.7 The ANZ also described a MIS RE, in this case Timbercorp, as a company that was complex with products at the higher risk end.[6] The bank did not have Timbercorp on its approved product list because it did not fit the profile of its client base. Mr Graham Hodges, Deputy CEO of ANZ, explained:

> Our adviser product teams deemed that it was not a product that our clients would be interested in, because it was known at the time to be a more tax driven, high-risk product.[7]

14.8 Yet these financial products were marketed and sold to a number of unwary investors who had not been properly informed of, or understood, the complexity, or inherent high risk of their investment or loan. As noted previously, these were retail investors relying heavily on the advice of their advisers and who, on their own admission, had limited capacity to understand or appreciate the risks posed by the

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4 Consumer Action Law Centre, *Submission 120*, p. 7 to the committee's inquiry into the performance of the Australian Securities and Investments Commission.

5 *Submission 161*, p. 7.

6 Mr Graham Hodges, evidence to the committee's inquiry into Scrutiny of Financial Advice, *Proof Committee Hansard*, 21 April 2015, p. 26.

7 Evidence to the committee's inquiry into Scrutiny of Financial Advice, *Proof Committee Hansard*, 21 April 2015, p. 26.

investment. This situation raises the question whether such complex products should have been promoted and sold to retail investors.

Suitability for retail investors

14.9 Years before the MIS failures, concerns were expressed about the schemes being marketed to retail investors. In 2001, ASIC expressed frustration at the high proportion of remedial action and surveillance activity expended on the agribusiness managed investments sector. It posed the question whether these schemes should be regulated in some other way. At that time, Mr Ian Johnston, ASIC, said:

> We note that, in some jurisdictions, public offering of these types of investments is not permitted. While not at this stage advocating such a position in Australia, we do note that as a regulator we conduct a policy, disclosure and conduct regime which achieves particular results in the case of much of the regulated managed investments population but which does not achieve those results with this sector.[8]

ASIC's oversight of financial products

14.10 ASIC, however, does not have legislative responsibilities for regulating financial products, only for the oversight of product providers. This responsibility focuses on 'matters of corporate governance and disclosure, and in the main not on the design and other issues related to the products they sell to consumers'.[9]

14.11 During its 2014 inquiry, the committee took evidence from a range of witnesses who advocated strongly for product regulation to address problems with complex products. In this regard, the consumer advocacy associations argued before the committee that unsafe products should be identified and a system introduced to restrict access to particular types of challenging products.[10] For example, the Consumer Action Law Centre favoured an approach that would empower ASIC to regulate financial and credit products, which, in its view, would give the regulator more power to respond quickly to emerging problems before widespread consumer harm occurred.[11]

14.12 At that time, Professor Dimity Kingsford Smith cited the Westpoint and Storm collapses and the associated investor losses from transactions that were

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8 Senate Economics Committee, *Inquiry into mass marketed tax effective schemes and investor protection,* Final Report, February 2002, paragraph 4.75.

9 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.6.

10 Consumer Credit Legal Centre (NSW) and Consumer Action Law Centre, evidence to the committee's inquiry into the performance of *ASIC, Committee Hansard*, 20 February 2014, pp. 41–42.

11 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.13.

relatively complex when analysed in full. The agribusiness MIS would also fit this category. In her view, 'in some other countries such products would have been limited to sophisticated investors but in Australia they could be offered to consumers'.[12] She explained further:

> The risk levels, the complexity, the consequent opacity of the advice and the fact that investors did not really understand the significance of the recommendations for their longer term financial welfare, all diminished the capacity of investors to make good investment decisions with properly informed consent.[13]

14.13 The Consumer Action Law Centre and Professor Kingsford Smith referred to the UK Financial Conduct Authority (FCA) model which allows the FCA to suspend or ban potentially harmful products.[14] Professor Kingsford Smith noted:

> In Britain the 'Treating Clients Fairly' program of the Financial Conduct Authority allows the regulator to intervene in the design of the product, not just place a stop order on disclosure. We think there is also room for ASIC to exercise powers to prohibit the issue of certain products in retail markets, if it is thought they are too complex, risky or leveraged to be appropriate.[15]

14.14 With the same idea in mind, the Law Council of Australia suggested that:

> …'merits' regulation of financial products for unsophisticated investors may need to be considered in Australia. That is, unsophisticated investors might need to have a limited range of investment choices that are limited to investments that are appropriate to their needs and circumstances or that have been approved by a regulator such as ASIC.[16]

14.15 The Rule of Law Institute of Australia contended that it was 'insufficient for government regulators to tell consumers and investors to be careful and self-educate themselves in the complex area of financial services, particularly when the ASIC Act

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12 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.14, p. 438. Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer', *Company and Securities Law Journal*, 29:5, 2011, p. 336.

13 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.14, p. 438. Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer', *Company and Securities Law Journal*, 29:5, 2011, p. 336.

14 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, pp. 438–439. *Submission 120*, p. 8 and Professor Dimity Kingsford Smith, *Submission 153*, p. 8 to that inquiry.

15 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.15, p. 438. Professor Dimity Kingsford Smith, *Submission 153*, p. 8 to that inquiry.

16 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.16, p. 438. Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 4 to that inquiry.

itself was nearly 400 pages in length'.[17] The FPA recommended that the laws be amended 'to oblige ASIC to take a larger role in the regulatory oversight of financial products before they are released for consumer investment'.[18] For example, it argued:

> Legislation must enable ASIC to effectively and proactively regulate product providers and the products they develop and sell to consumers. Product providers should be held accountable for failing to deliver on product benefits due to dishonest conduct, fraud or insolvency, or if there are fundamental flaws in products.[19]

14.16 ASIC can issue a stop order on a prospectus, where it determined that the document was deficient.[20] Even so, it has acknowledged the inherent limitations in a regulatory approach that relies solely on disclosure to address some of the problems investors face in financial markets. ASIC told the committee in 2014, that it understood that the effectiveness of disclosure can be undermined because:

- people may not read or understand mandated disclosure documents, due to factors such as inherent behavioural biases or a lack of financial literacy skills, motivation and time; and
- the complexity of many financial products may mean that disclosure for such products can also be lengthy and complex, or excessively simplified and generalised.[21]

14.17 ASIC also referred to the FCA's work in 'product intervention'. It noted that the FCA would 'periodically review particular financial services market sectors and examine how products are being developed, and the governance standards that firms have in place to ensure fairness to investors in the development and distribution of products'. To assist this process, the FCA had a spectrum of temporary 'product intervention' powers which may include rules:

- requiring providers to issue consumer or industry warnings;

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17 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.17, p. 439. Rule of Law Institute of Australia, *Submission 211*, p. 7 to that inquiry.

18 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.18, p. 439. *Submission 234*, p. 31 to that inquiry.

19 Financial Planning Association of Australia, *Submission 234*, p. 26 to committee's inquiry into the performance of the Australian Securities and Investments Commission.

20 Mr Greg Medcraft, Chairman, ASIC, committee's inquiry into the Performance of the Australian Securities and Investments Commission, *Committee Hansard*, 19 February 2014, p. 19.

21 ASIC, answer to written question on notice No 9, p. 10 of 59, (received 21 May 2014), to committee's inquiry into the performance of the Australian Securities and Investments Commission.

- requiring that certain products are only sold by advisers with additional competence requirements;
- preventing non-advised sales or marketing of a product to some types of consumer;
- requiring providers to amend promotional materials;
- requiring providers to design appropriate charging structures;
- banning or mandating particular product features; and
- in rare cases, banning sales of the product altogether.[22]

14.18 In ASIC's view, having a broader and more flexible regulatory toolkit would 'enhance its ability to foster effective competition and promote investor and consumer protection'. In its view, regulating product suitability was 'one type of approach that has been adopted internationally'. ASIC concluded:

> As the FCA's regulatory approach is relatively new, at this stage, it is difficult to draw any settled conclusions about the positive or negative aspects of such an approach. However, the Government may wish to consider whether such a broader regulatory toolkit would be appropriate in the Australian financial regulatory system.[23]

14.19 During its 2014 inquiry, the committee also drew attention to Mr Richard St. John's report on compensation arrangements for consumers of financial services and his reference to the international regulatory community's new focus on the adequacy of conduct and disclosure regimes. In his view, it would be timely 'to consider measures by which product issuers could assume more responsibility for the protection of consumers who look to invest in their products'.[24] He noted the consideration being given 'to the possibility of a more interventionist approach with product issuers'. In his words, the aim would be 'to catch problems early on in a financial product's life cycle as a means of preventing widespread detriment to consumers'.[25] Referring directly to agribusiness MIS, Mr St. John suggested that:

> As a matter of strategic approach, it would be timely to review the present light-handed regulation of certain product issuers, in particular managed investment schemes, including the possible need, in accord with

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22 ASIC, answer to written question on notice No. 9, p. 10 of 59, (received 21 May 2014), to committee's inquiry into the *Performance of the Australian Securities and Investments Commission*.

23 ASIC, answer to written question on notice No. 9, p. 11 of 59, (received 21 May 2014) to committee's inquiry into the *Performance of the Australian Securities and Investments Commission*.

24 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 104.

25 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 104.

> developments at the international level, to move to a somewhat more interventionist approach.[26]

14.20 As a first step, he suggested that consideration could be given to imposing on licensees who make products available for retail clients more responsibility for the suitability of those products for such investors, together with related disclosure obligations.[27]

14.21 Having deliberated on the evidence before it, the committee, in its June 2014 report, expressed concern that Australia was out of step with international efforts to implement measures that would address problems associated with the marketing of unsafe financial products to retail investors.

14.22 At that time, the committee recommended that the government give urgent consideration to expanding ASIC's regulatory toolkit so that the regulator would be able to intervene in the marketing of unsafe or inappropriate products to retail investors. As a preliminary phase in this staged process, the committee noted that the FSI may have a role and recommended that it consider carefully the adequacy of Australia's conduct and disclosure approach to the regulation of financial product issuers as a means of protecting consumers. In particular, the committee recommended that the FSI consider the implementation of measures designed to protect unsophisticated investors from unsafe products, including matters such as:

- subjecting the product issuer to more positive obligations in regard to the suitability of their product;
- requiring the product issuer to state the particular classes of consumer for whom the product is suitable and the potential risks of investing in the product;
- standardised product labelling;
- restricting the range of investment choices to unsophisticated investors;
- allowing ASIC to intervene and prohibit the issue of certain products in retail markets.

14.23 The committee also recommended that the FSI assess the merits of the United Kingdom's Financial Conduct Authority model which allows the authority to suspend or ban potentially harmful products.[28]

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26 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 113.

27 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 146.

28 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.32 (Recommendation 58).

14.24 The FSI did indeed look into this matter. In its final report, the FSI cited cases where ASIC lacked 'a broad toolkit to respond effectively, and in a timely way, to an emerging risk of significant consumer detriment and cited, in particular, instances where leveraged investment strategies exacerbated the loss for many consumers. Notably, the FSI referred to agribusiness MIS where the product 'did not perform in the way that consumers were led to believe, including schemes relying on ongoing sales to fund their operations.' It observed further:

> Many consumers did not understand the potential risk of borrowing to invest in these products. In total, more than 65,000 consumers invested and lost close to $3 billion.[29]

14.25 In the FSI's view, targeted early intervention would be more effective in reducing harm to consumers rather than waiting until detriment occurred. It argued that the regulator should be able to be proactive in its supervision and enforcement. In its assessment, significant consumer harm could be reduced 'if ASIC had the power to stop a product from being sold or, where the product had already been sold, to prevent the problem from affecting a larger group of consumers'.[30] The FSI recommended that the government should amend the law to provide ASIC with a product intervention power. It stated:

> ASIC should be equipped to take a more proactive approach to reducing the risk of significant detriment to consumers with a new power to allow for more timely and targeted intervention. This power should be used as a last resort or pre-emptive measure where there is risk of significant detriment to a class of consumers. This power would enable intervention without a demonstrated or suspected breach of the law. Given the potential significant commercial impact of this power, the regulator should be held to a high level of accountability for its use.[31]

14.26 The FSI explained further that this power would allow the regulator to intervene to require or impose:

- amendments to marketing and disclosure materials;
- warnings to consumers, and labelling or terminology changes;
- distribution restrictions; and
- product banning.

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29 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 208, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

30 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 209, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

31 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 206, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

14.27 The power would be limited to temporary intervention for 12 months, with the option for government to grant an extension, and a provision for the intervention to be subject to a judicial review mechanism.[32]

Strengthen product issuer and distributor accountability

14.28 Turning to the product manufacturer, the FSI stated that product regulation and product issuer regulation needed to be considered more carefully in order that those entities bear the appropriate responsibility for a fair, safe, and efficient financial services system.[33] The report recommended that a principles-based product design and distribution obligation be implemented for product issuers, explaining further:

> **During product design**, product issuers should identify target and non-target markets, taking into account the product's intended risk/return profile and other characteristics. Where the nature of the product warrants it, issuers should stress-test the product to assess how consumers may be affected in different circumstances. They should also consumer-test products to make key features clear and easy to understand.
>
> **During the product distribution process**, issuers should agree with distributors on how a product should be distributed to consumers. Where applicable, distributors should have controls in place to act in accordance with the issuer's expectations for distribution to target markets.
>
> **After the sale of a product**, the issuer and distributor should periodically review whether the product still meets the needs of the target market and whether its risk profile is consistent with its distribution. The results of this review should inform future product design and distribution processes. This kind of review would not be required for closed products.[34]

14.29 According to the FSI, a serious breach of this obligation should be subject to 'a significant penalty'.[35] The FSI formed the view that 'better aligning the interests of financial firms with consumer interests, combined with stronger and better resourced regulators with access to higher penalties, should lead to better consumer outcomes'.[36]

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32 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 206, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

33 *Submission 161*, p. 4.

34 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 198, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014) and *Submission 161*, p. 5.

35 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 199, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

36 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, pp. 221 and 236, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

14.30 Consistent with its evidence to the committee's 2014 inquiry, ASIC informed the committee that it supported a shift to 'a regulatory philosophy that acknowledges that different tools will be needed to address different problems'. It suggested that this regime would focus on the development of a detailed understanding of specific market problems as they arise—often referred to as 'a product intervention approach'.[37]

Product and product issuer regulation

14.31 Evidence taken as part of the committee's inquiry into MIS builds on the strong case supporting the committee's initial 2014 recommendations and those of the FSI for ASIC to have a financial product intervention power and for product issuers to be subject to greater obligations relating to consumer protection.

14.32 For example, as noted earlier, many members of the FPA did not include agribusiness MIS on their approved product list. The FPA, which held the view that forestry and agribusiness projects, as well as the underlying MIS structure, were very complex, asked whether retail investors could reasonably be expected to understand these structures.[38] In its assessment, part of this bias towards regulating the distribution end of a financial product was due to Australia's disclosure-oriented regulatory focus which 'explicitly excludes financial product quality and research quality from scrutiny'.[39] According to FPA, consumer protection would be significantly strengthened if ASIC were to have the power to 'step in early, in a proactive sense where it can see things are not in the consumers' best interest' and to take action against the managers of the scheme.[40] The FPA recommended that Treasury review the Corporations Act and/or the ASIC Act to consider how product intervention powers for ASIC could be implemented.[41] AgriWealth, which operates a traditional forestry business and a MIS forestry business, also noted that there could be a restriction on MIS products being offered to wholesale investors only.[42]

14.33 Mr David Cornish, who has been involved in assessing rural investments for the past 25 years, also questioned why these products were 'allowed to be offered at a retail level to the person in the street?' [43] He concurred with the view that investments in products that are not traditional 'securities' as the underlying investment should not be marketed directly to retail investors. Mr Cornish maintained:

> Agricultural investment for the general public should only be available through the wholesale or professional market. This would provide the

37 *Submission 34*, paragraph 7.

38 *Submission 161*, p. 7.

39 *Submission 161*, p. 4.

40 Mr Mark Rantall, *Proof Committee Hansard*, 6 August 2015, p. 26.

41 *Submission 161*, p. 9.

42 *Submission 138*, p. 2.

43 *Proof Committee Hansard*, 4 August 2015, p. 13.

individual investor the protection of a wholesale institution that will do the correct due-diligence on their behalf and the ability to spread risk across a number of investments.[44]

14.34 According to Mr Cornish, because the complexity and the risk involved in agricultural investment was 'simply outside the grasp of your average person in the street', the UK had 'wisely decided their marketing should be limited'.[45] Consistent with this approach, Mr Cornish recommended that legislation be introduced in Australia disallowing investments, other than those retail investments that can be considered traditional 'securities', being marketed directly to the retail investor.[46]

14.35 Mr Mervin Reed, a Chartered Financial Adviser with 25 years' experience in the industry, argued that basically ASIC produced the product failures—it was a regulator that 'allowed the product onto the market and it is the regulator of the market product'.[47] He explained:

> Presently the regulator does not essentially review the product, merely that the product provider or the new product has to meet basic requirements of the prospectus, and as long as it fits then it's an administrative function, the regulator gives it its authorisation code, and a way it goes into the market.
>
> There is no detailed understanding by the regulator of what the product is, whether it will deliver what its prospectus says it will; how well it will deliver this; who will deliver this outcome for investors; and what is their background experience and capacity to make such statements in the prospectus.[48]

14.36 Mr Reed suggested:

> …the regulator should engage a panel of external auditors, develop a new product approval matrix, that deals with the basis of the product, the legal structures involved, the bankers involved, the management team involved, their experience over time, the administrative arrangements, and the fund management specialisation and internal skill bases, that will allow the product provider to actually deliver on the prospectus.[49]

14.37 In Mr Reed's view, once the product had been allowed onto the market, another audit should be conducted 18 months after the product's initial release to the market, which would be provided to ASIC 'in order for the product to continue to be on the market'.[50] Mr Reed reasoned that this process would remove the requirement

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44 *Submission 60*, p. 10.

45 *Proof Committee Hansard*, 4 August 2015, p. 13.

46 *Submission 60*, pp. 2, 11 and 20.

47 *Submission 20*, p. [2].

48 *Submission 20*, p. [2].

49 *Submission 20*, p. [2].

50 *Submission 20*, p. [2].

for ASIC to have in-house specialisation and that expertise existed 'in abundance in the major auditing firms'.[51] He argued:

> There are numerous examples that all would have been cut off at the knees and been stillborn, and thus not a problem if this process of ASIC employing external auditors and new matrix structures on which to assess managed investment product prior to product meeting the market.[52]

14.38 Most recently, Mr Greg Medcraft, Chairman ASIC, indicated that the push for greater product intervention had not subsided and highlighted the importance of implementing stronger regulations to govern product designers. He spoke of regulators throughout the world considering 'a broader toolkit to address market problems, including moving away from purely disclosure-based regulation'. Mr Medcraft referred to the International Organization of Securities Commissions (IOSCO), which has recommended that regulators look across the financial product value chain, rather than simply disclosure at the point of sale. He explained:

> A product intervention power would give ASIC a greater capacity to apply regulatory interventions in a timely and responsive way. It would allow ASIC to intervene in a range of ways where there is a risk of significant consumer detriment.[53]

14.39 According to Mr Medcraft, if ASIC had product intervention power it would be able to undertake a range of actions, including simple 'nudges', right through to product bans, though noting:

> Most interventions would likely fall well short of product banning. For example, we might be able to require amendments to marketing materials, or additional warnings. In more extreme cases, we might be able to require a change in the way a product is distributed or, in rare cases, ban a particular product feature.[54]

14.40 Mr Medcraft also responded to the FSI's recommendation for placing a broad-based obligation on financial institutions to have regard to the needs of their customers in designing and targeting their products. In his view:

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51 *Submission 20*, p. [3].

52 *Submission 20*, p. [3].

53 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 3, http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf (accessed 7 September 2015).

54 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 3, http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf (accessed 7 September 2015).

> …the FSI's recommendation aligns very closely with the theme of culture. Product manufacturers should design and distribute products with the best interests of the investor or financial consumer in mind. This is part of having a customer-focused culture.[55]

14.41 On the call for increasing the penalties for contravening ASIC legislation, Mr Medcraft observed, as did the FSI, that:

> Comparatively, the maximum civil penalties available to us in Australia are lower than those available to other regulators internationally. And they are fixed amounts, not multiples of the financial benefit obtained from misconduct.[56]

14.42 The government agreed with the FSI's recommendation to provide ASIC with a financial product intervention power to enable it to modify, or if necessary, ban harmful financial products where there is a risk of significant consumer detriment. The government plans to consult with stakeholders to ensure that the power strikes the right balance—providing ASIC with a tool to enable it to take action in exceptional circumstances but without stifling industry innovation.[57]

14.43 Similarly, the government agreed with FSI's recommendation to introduce a 'targeted and principles-based product design and distribution obligation'. Again the government undertook to consult with stakeholders on the implementation of this recommendation.[58] The government also supported the FSI's call for industry-led initiatives to improve disclosure of risk and fees.[59]

Conclusion

14.44 There can be no doubt that much stronger measures are needed to protect retail investors from the promotion and marketing of high risk products. A number of inquiries, including the committee's 2014 inquiry into the performance of ASIC and

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55 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 4, http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf (accessed 7 September 2015).

56 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 4, http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf (accessed 7 September 2015).

57 Australian Government, *Improving Australia's financial systems*, Government response to the Financial System Inquiry, p. 19.

58 Australian Government, *Improving Australia's financial systems*, Government response to the Financial System Inquiry, p. 19.

59 Australian Government, *Improving Australia's financial systems*, Government response to the Financial System Inquiry, p. 19.

the FSI have mounted a compelling argument for such action. Agribusiness MIS is a clear example of where, based on the evidence before the committee, disclosure was inadequate; information was confusing rather than instructive for retail investors; and oral advice either misinterpreted the disclosure documents, downplayed risks, or selectively presented positive messages. Clearly, improved regulation could have prevented many unwary investors from entering into unsafe financial arrangements.

14.45 The committee is of the view that Australia's financial services regulatory regime has not served Australian investors well and can no longer be relied as a means of consumer protection. While improved disclosure and education are necessary, they must be accompanied by other measures. Attention must also be given to product issuers and their obligation to act in the best interests of investors.

14.46 The committee welcomes the government's endorsement of the FSI's recommendation to confer on ASIC a product intervention power and an obligation on product issuers to ensure that the products they are marketing to retail investors are appropriate. The committee is firmly of the view that penalties commensurate with the offence are needed to send a strong message to product issuers to act responsibly when marketing products to retail investors. In light of the FSI and ASIC's observation regarding the importance of having higher penalties, the committee calls on the government to consider increased penalties for serious breaches.

Recommendation 19

14.47 To augment ASIC's product intervention power, the committee recommends that the government review the penalties for breaches of advisers and AFS Licensees' obligations and, under the proposed legislation governing product issuers, ensure that the penalties align with the seriousness of the breach and serve as an effective deterrent.

Part IV—Aftermath of failed MIS: winding up schemes, compensation for losses and lessons to be learnt

Agribusiness MIS were complex financial products and the problems due to this complexity became increasing evident as some schemes began to fail and external administrators tried to salvage the businesses and ultimately manage the liquidation process.

In this part of the report, the committee examines the difficulties external administrators faced in endeavouring to rescue a failing scheme. It deals with appointing a replacement responsible entity; the functions, responsibilities, obligations of, and complexities confronting administrators including disentangling the affairs of related entities and reconciling competing interests.

The committee also examines the effects of failed MIS on the environment and on farmers who leased land to such enterprises and, overall, the future for agribusiness MIS in Australia with a particular emphasis on using tax concessions as an incentive to invest.

Chapter 15

Liquidation

15.1 Evidence before this committee has highlighted the complicated task of untangling the interests of the various parties affected when an MIS gets into financial difficulties and ultimately fails. In this regard, it should be noted that in November 2010, the government commissioned a review by the Corporations and Markets Advisory Committee (CAMAC) into the current statutory framework for all MIS. This review was in the context of the problems that had arisen for scheme members and creditors where a scheme became financially stressed and the uncertainty around arrangements for dealing with unviable schemes.[1] CAMAC delivered its report to government in July 2012.

15.2 In this chapter, the committee considers the difficulties involved in winding-up an agribusiness MIS and the findings of CAMAC's review.

Complex arrangements

15.3 In 2010 in a submission to the then Treasurer the Hon Wayne Swan, the Law Council of Australia described how the collapse of an agribusiness MIS generally occurred:

- the group of companies, including the RE, becomes insolvent—often blaming the recent GFC, but usually as a result of being unable to refinance their facilities;
- a secured creditor (generally a bank) issues default notices under its facility agreements;
- the RE can no longer afford to maintain the crop and there is a risk that it will die, thereby creating a substantial loss value to the investors/growers and risking the landowner's ability to sell the property;
- the land owning entity seeks to cancel its head lease with the RE, which in turn will cancel the subleases to the investor/grower;
- the secured creditor of the land seeks to sell the land;

1 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, p. 2, http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2012/$file/mis_report_july2012.pdf (accessed 9 June 2015).

- a dispute arises as to what proportion of the sale price relates to the value of the land *vis-à-vis* the scheme property (which usually comprises the crop and some other hard assets).[2]

MIS in external administration

15.4 When the RE of an MIS goes into external administration, control of the company and its operations passes from the directors to the insolvency practitioners appointed to conduct the administration. According to ASIC:

> Depending on the nature of the external administration, the insolvency practitioner may be an administrator (appointed by the directors or a secured creditor under the voluntary administration regime in Pt 5.3A of the Corporations Act), a receiver, or a receiver and manager of the property of the responsible entity (usually appointed by a secured creditor), or a liquidator.[3]

15.5 Once an insolvency practitioner is appointed to the RE, the external administrator's first priority is to determine whether or not the MIS is viable. If viable, either its members can appoint a new RE or the Court can appoint a temporary RE.[4] Under the Corporations Act, ASIC may suspend or cancel the AFS licence of an RE that becomes an externally administered body corporate. ASIC informed the committee that generally it would discuss this proposal with the external administrator to determine whether such action could potentially cause issues with the ongoing operation of the schemes. Where ASIC has not cancelled the AFS licence, it would monitor the conduct of the RE in external administration, including its compliance with key conditions of its licence.[5] ASIC's approach to the appointment of external administrators to a RE generally involves engaging with them to:

- discuss the terms of appointment and identify whether they are independent and sufficiently resourced to conduct the administration;
- establish lines of communication and contact points between ASIC and the external administrator;
- inform the external administrator of ASIC's expectations in relation to the administration, including having due regard to the interests of members of the schemes operated by the responsible entity; and
- obtain information about the entities involved and the potential effects on investors.

2 Law Council of Australia, submission to the Treasurer the Hon Wayne Swan, p. 3, http://www.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/docs-2300-2399/2351%20Managed%20Investment%20Schemes.pdf (accessed 7 September 2015).

3 ASIC, *Submission 34*, paragraph 126.

4 *Corporations Act 2001*, s 601FM and s 601FP.

5 ASIC, *Submission 34*, paragraph 125.

15.6 ASIC would also consider proposals about the future of the schemes; of the responsible entity's AFS licence; and what action ASIC should take in response to the administration. According to ASIC, it monitors the administration generally through regular meetings with the external administrators.[6]

Replacement RE

15.7 One of the insolvency practitioner's most challenging tasks is to find a suitable or willing replacement RE. ASIC described this process:

> It takes an external administrator some time to understand the arrangements of the entities that they have been appointed to and potential avenues for dealing with the schemes. External administrators will generally obtain reports from experts about the viability of schemes, while also commencing campaigns to determine whether there are any responsible entities interested in becoming the responsible entity for some or all of the schemes the responsible entity operates.[7]

15.8 But, finding a replacement RE can be problematic. In this regard, CAMAC found:

> In some situations, the responsible entity (RE) of a viable scheme may act in a manner, or in some other capacity suffer financial loss, that makes that RE ineligible or unsuitable to continue in its role as operator of the scheme. However, the future of the scheme may be placed in jeopardy through difficulties in immediately securing a suitable replacement RE, given that a scheme cannot continue without an RE.[8]

15.9 Numerous people involved in the external administration of a struggling agribusiness MIS have highlighted the impediments to securing a replacement RE.

Responsibilities of the replacement RE

15.10 With few exceptions, if the RE of a registered scheme changes, the new responsible entity assumes all the rights, obligations and liabilities in relation to the scheme of the former RE.[9] In this regard, Justice Barrett, Judge of the Supreme Court of New South Wales, observed that if a temporary RE is to be appointed, there must be some qualified company willing to be appointed. He noted that this may be a problem:

> When a new responsible entity takes office, it becomes, under s 601FS, the statutory inheritor of the rights, obligations and liabilities of the old responsible entity in relation to the scheme…In our postulated situation, the

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6 *Submission 34*, paragraph 134.

7 *Submission 34*, paragraph 118.

8 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, p. 3.

9 *Corporations Act 2001*, s 601FS.

> successor will come to owe the debts that brought the old responsible entity undone and to have the rights of recoupment that were insufficient to allow it to continue. Simple replacement of the responsible entity in liquidation therefore does not seem a practical possibility. The automatic vesting of the non-viable combination of liabilities and inadequate rights of recoupment must mean that, in the real world, there will never be a new responsible entity.[10]

15.11 ASIC in its submission to the court hearing the matter of Timbercorp Securities Limited in liquidation also drew on the above quote from Justice Barrett.[11] ASIC informed the committee that, historically, it has been difficult for external administrators to find replacement responsible entities, due to a number of issues, including:

- the effect of s 601FS and s 601FT of the Corporations Act to transfer the rights and obligations of the existing RE to any replacement RE in the context of an enterprise scheme where the extent of the liabilities and obligations are extensive, or at least uncertain;
- the lack of funding available to the replacement RE for the continuing operation of the scheme;
- doubts about the viability of the scheme(s); and
- a limited number of potential responsible entities with the experience and resources to take on the scheme(s).[12]

15.12 Ultimately, where a replacement RE cannot be found, a scheme may need to be wound up.

15.13 Willmott Forests Limited (WFL) provided an example of the difficulties involved in securing a replacement RE. The scheme was a forestry scheme, involving 14 plantations, with each grower taking a lease of one or more hectares of land on which to grow timber. That timber was to be harvested and sold about 16 to 25 years after planting. The leased land was registered in the name of WFL. The liquidators

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10 R. I. Barrett, 'Insolvency of Registered Managed Investment Schemes', Banking and Financial Services Law Association, Queenstown, New Zealand, July 2008, pp. 11–12, http://www.supremecourt.justice.nsw.gov.au/Documents/barrett260708.pdf. See also, Leon Zwier, Justin Vaatstra, and Oren Bigos, 'Can Managed Investment Schemes be Restructured?', 10 September 2014, p. 2, http://www.vicbar.com.au/GetFile.ashx?file=CPDAdjournedFiles%2F1057_10092014_ABL+MIS_RESTRUCTURING_PAPER.pdf (accessed 22 September 2015).

11 The Supreme Court of Victoria at Melbourne, Commercial and Equity Division, Commercial Court, Timbercorp Securities Limited (in liq) ACN 092 311 469, ASIC's submission, 14 July 2009, p. 5, http://www.kordamentha.com/docs/51_03_timbercorp-almond-schemes/asic%27s-outline-of-submissions-(14-july-2009).pdf (accessed 4 December).

12 *Submission 34*, paragraph 119. Section 601FS deals with the rights, obligations and liabilities of a former responsible entity. Section 601FT covers the effect of change of responsible entity on documents etc. to which a former responsible entity is party.

found that the Willmott schemes could not continue to operate.[13] They considered that:

> …it was 'very unlikely' that 'a party would be willing to take over as responsible entity and manager of the Willmott Schemes in circumstances where that party would be required to assume the liabilities of WFL and fund the continued operation of the Willmott Schemes without any income or contributions from [individual investors] until harvest'. The liquidators further concluded that it would not be practicable to maintain separately, or harvest separately, the trees on any individual lot leased to a particular investor and that the individual investors' 'right to maintain and harvest their own trees is a theoretical right which cannot be exercised'.[14]

15.14 PPB Advisory informed the committee of the steps it followed in endeavouring to salvage and wind-up this company. It advised that, by order of the Federal Court of Australia on 26 October 2010, Mr Ian Carson and Mr Craig Crosbie, partners of PPB Advisory, were appointed joint and several administrators of WFL and its related companies.[15]

15.15 As administrators, and later liquidators, of WFL, they were required to deal with WFL's role as responsible entity/manager/trustee of the WFL schemes. Early on, they engaged a forestry expert to 'undertake a technical view and verification of the viability of the WFL schemes, including assumptions and cash flow forecasts'. That review found that 'over the life of the WFL schemes, WFL would require funding in excess of $300 million (in absolute terms) and that the vast majority of the schemes would not be viable'.[16]

15.16 The administrators commenced a campaign seeking expressions of interest from parties wishing to (among other things) take over the obligations of responsible entity/manager/trustee for any or all of the WFL schemes. Unsuccessful in finding a party willing to step into that role on an unconditional basis, resolutions were passed at a meeting of investors in one of the schemes to appoint another party as responsible entity.[17]

15.17 But unable to find a replacement responsible entity for all schemes, the liquidators obtained directions from the Federal Court of Australia to enable them to commence a sale process for the WFL scheme assets.[18]

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13 Willmott Growers Group Inc v Willmott Forests Limited (recs and mgrs apptd) (in liq) [2013] HCA 51 (4 December 2013), [15].

14 Willmott Growers Group Inc v Willmott Forests Limited (recs and mgrs apptd) (in liq) [2013] HCA 51 (4 December 2013), [15].

15 Response from PPB Advisory to *Submission 187,* received 6 February, 2015, p. 1.

16 Response from PPB Advisory to *Submission 187,* received 6 February, 2015, p. 1.

17 Response from PPB Advisory to *Submission 187,* received 6 February, 2015, p. 1.

18 Response from PPB Advisory to *Submission 187,* received 6 February, 2015, p. 2.

15.18 As administrators and later liquidators for Gunns Plantations Limited, PPB Advisory followed a similar process—engaged a forestry expert, undertook a campaign seeking expressions of interest for a replacement RE and following this unsuccessful attempt obtained directions from the court to commence a competitive sale process for the Gunns scheme assets.[19]

15.19 A second major difficulty for external administrators involved unravelling the intricate web of agreements comprising the scheme.

Network of agreements and competing interests

15.20 CAMAC observed that the problems encountered with the operation of schemes in recent years had arisen principally, if not exclusively, in the context of common enterprise schemes. These problems centred on the difficulties that occur from the intermingling of the affairs and property of the scheme itself and of its members.[20]

15.21 Relevantly, CAMAC noted that common enterprise schemes are often structured as a series of bilateral or multilateral executory agreements between the member, the RE and various external parties:

> The 'scheme' in that case is not a pool of assets under management, but rather the common enterprise carried out over time in accordance with those agreements. For instance, for taxation or other reasons, various agribusiness common enterprise schemes were structured so that scheme members ('growers') operated their agribusiness investment in their own right, entering into agreements with the RE or external parties to perform the cultivation and management activities associated with the member's enterprise. Scheme members would hold various forms of proprietary or contractual interests in allocated parcels of land, which may be owned by an external party.[21]

15.22 According to CAMAC, with that type of scheme, complex problems could arise 'in determining the nature of the rights of scheme members'. Furthermore, there could be difficulties 'clearly distinguishing during the operation of the scheme

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19 Response from PPB Advisory to *Submission 187*, received 6 February, 2015, p. 2.

20 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, p. 10. http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2012/$file/mis_report_july2012.pdf (accessed 9 June 2015).

21 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, pp. 27–28, http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2012/$file/mis_report_july2012.pdf (accessed 9 June 2015).

between the property of the scheme and the property of scheme members used in the enterprise'.[22] CAMAC found:

> Recent experience with the collapse of some agribusiness common enterprise schemes points to the possibility of confusion arising in attempting to untangle these arrangements, with a range of involved parties, including scheme members, each seeking to assert what they perceive to be their proprietary and other rights and attempting to determine the way forward, often in an environment of conflict and resort to litigation.[23]

15.23 ASIC also highlighted the difficulties that administrators face when winding up a failed MIS, which involved undoing the series of interlocking contracts between the growers and the RE, the sub-leases of the land and management agreements for the planting, husbandry and harvest. Based on its experience, ASIC explained the complications facing administrators and liquidators of MIS:

> …external administrators of responsible entities that operate forestry schemes are faced with a complex web of arrangements with limited resources available for the continued operation of the schemes. They also face conflicts in their responsibility to creditors and their duties to members of the schemes.[24]

15.24 In particular, ASIC noted that the effect on ownership rights is 'not always clear as a matter of law'. It observed that this difficult task of unravelling ownership rights and the lack of clarity in the law has meant that external administrators seek judicial guidance.[25] In this regard, ASIC observed:

> Generally, external administrators have sought directions from the courts about the winding up of forestry schemes because it generally involves dismantling arrangements with a variety of parties, including land owners and investors to sell assets (such as land owned by the responsible entity or other third party on which trees are planted) to meet the claims of creditors of the responsible entity and members of the scheme.[26]

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22 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, pp. 28–29, http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2012/$file/mis_report_july2012.pdf (accessed 9 June 2015). See also Corporations and Markets Advisory Committee, *The establishment and operation of managed investment schemes*, Discussion paper, March 2014, p. 13.

23 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, p. 10, http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2012/$file/mis_report_july2012.pdf (accessed 9 June 2015).

24 *Submission 34*, paragraph 117.

25 *Submission 34*, paragraph 46.

26 *Submission 34*, paragraph 120.

15.25 WFL exemplified the hurdles encountered when winding up an agribusiness MIS and the liquidators recourse to the courts. According to PPB Advisory, following the unsuccessful attempt to secure a new RE, the sale of WFL scheme's assets was a complex process involving numerous applications to the courts. For example, the liquidators applied to the Supreme Court of Victoria for directions and orders about the sales that had been negotiated. The court determined that the liquidators were not able 'to disclaim the Growers' leases with the effect of extinguishing the Growers' leasehold estate or interest in the subject land'. The Appeal Court, however, confirmed by the High Court, set aside the order and determined that the liquidators did have the power to disclaim the leases to investors.[27] When a purchaser was identified from the competitive sale process, the liquidators sought further approval from the Supreme Court of Victoria to proceed with the sale.[28] The liquidators conducted a competitive sale process for WFL scheme assets and 'sold the assets for the best price obtainable in a sale process that was approved by the Supreme Court of Victoria'.[29]

Interests of the members

15.26 Sections 601FC and 601FD of the Corporations Act (duties of RE and their officers) impose an obligation on the RE and its officers to act in the best interests of the members of the scheme and, where there is a conflict of interest, to prefer the members' interests. ASIC noted, however, that the external administrator of a responsible entity has to manage the competing claims of:

- secured creditors, whose ultimate interest may be having the schemes (which relates to the land) wound up if the effect is to free the land from these encumbrances; and
- growers, whose ultimate interest is to realise the long-term production of their crops.[30]

15.27 According to ASIC, when a company is insolvent, the interests of its creditors come to the fore in deciding where the company's interests reside. In MIS, secured creditors of the responsible entity often have security over the land that is used by growers in the managed investment schemes. ASIC noted:

> The secured creditors will generally have a significant commercial interest in 'un-encumbering' the land over which they have security. The encumbrances on the land include leases and forestry of varying degrees of value and maturity, which are held by investors or by the responsible entity

27 Willmott Growers Group Inc v Willmott Forests Limited (recs and mgrs apptd) (in liq) [2013] HCA 51 (4 December 2013) [57] [78] [79].

28 Response from PPB Advisory to *Submission 187*, received 6 February 2015, p. 2.

29 Response from PPB Advisory to *Submission 187*, received 6 February 2015, p. 4.

30 *Submission 34*, paragraph 128.

> subject to an obligation to hold in accordance with its duties to members on their investment.[31]

15.28 The committee has described the general arrangements whereby growers leased portions of land which the RE or related company owned or leased. The growers' leases were made at various times and for a fixed period. Some leases provided for the whole of the rent due to be paid in advance while others required rent to be paid annually.

15.29 The Australian Restructuring Insolvency & Turnaround Association (ARITA) explained the complexities of winding up such schemes, including determining the rights of investors, and also referred to WFL:

> The decision of the Court was to allow the liquidator of WFL to 'disclaim' leases that had been granted to investors, in some cases, with the whole of the rent paid in advance, leaving them to prove for their losses in the winding up, with little prospect of a return. The investors lost any right to maintain and harvest trees that had been planted on the leased properties.
>
> The facts of that case reflected the particular circumstances of agribusiness schemes, where multiple long-term and often low-rent leases can encumber rural properties, causing those properties to become difficult to sell.
>
> The High Court's decision has broader implications for more common types of leasehold arrangements, particularly in situations where the liquidator of a landlord forms the view that a property may be more readily saleable, or sell for a higher price, without the existing leasehold arrangements in place. This was the case in Willmott Forests.[32]

15.30 As noted earlier, many investors were unclear on what they actually owned. Their rights became particularly contentious when the external administrators began the process of winding up the schemes. For example, in his judgement on 14 September 2009 relating to an MIS growing almonds, Justice Robson explained how growers' rights can be relinquished:

> The growers do not own the almond trees but rather have certain rights to crop the trees. The liquidators are of the view that to realise the maximum value for the land, equipment, and cropping rights (that is in effect the whole business) it may be necessary to offer the lot for sale or recapitalisation as a whole. To that end, the liquidators have amended the constitution of the relevant almond schemes to allow the responsible entity to surrender any interest the growers have in the almond groves. Such a power will enable the liquidators to offer the almond groves on an unencumbered basis to a buyer or a party willing to recapitalise the almond groves.
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> The relevant land is mortgaged to banks. If insufficient is realised to pay out the mortgagees, then any sale depends on the mortgagee banks agreeing

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31 *Submission 34*, paragraph 128.

32 *Submission 23*, p. 2.

> to discharge their mortgages in exchange for a sum less than they are owed. Naturally, the banks will be seeking to have as much as necessary allocated to the land value to discharge the mortgages.[33]

15.31 Many of the growers who wrote to the committee believed that in the process of untangling this complicated network of interests, they were the ones who lost out. Mr Jeff Chin noted:

> Whilst the current regulatory regime recognises that consumers of financial products and services require special protection, in liquidation these protections disappear. Significant powers and trust are delegated to the Liquidators—it is a privileged position where fair and objective behaviour is assumed. However, as has been discussed in other submissions, the Liquidator appointment process makes it very likely that Liquidators will pursue the interests of banks (as large repeat clients).[34]

15.32 In Mr Chin's view:

> …**in situations where the impact is wide, and where there are impediments to victims seeking justice, regulators of the Liquidator (ASIC) and Consumer Law (ACCC) ought to be intervening to assist grower borrowers to assert their rights.** If not, the Liquidator's intimidatory approach is likely to simply steamroll many innocent victims, cause widespread unnecessary distress and incur substantial unnecessary legal costs.[35]

15.33 ASIC acknowledged that, in practice, receivers and liquidators, experience difficulties managing 'the tension between their obligations to scheme members and their obligations to the creditors' of the RE.[36] It stated:

> In recent failures in the sector, it is apparent that (whatever the legal position) the fact that there is no person charged solely with representing members' interests has undermined investors' confidence in the capacity of the existing insolvency laws to protect their position.[37]

Forced sale

15.34 Many submitters dissatisfied with the winding up or liquidation process of the schemes were especially galled by the success of a scheme that had been sold by the liquidator. One submitter noted:

> The Liquidator KordaMentha, has closed all Timbercorp companies except Timbercorp Finance, and has since sold all assets including the Almond

33 Re Timber Securities Limited (in liq) (No 2) [2009] VSC 411 (14 September 2009) [7]–[8].

34 *Submission 144*, p. [1].

35 *Submission 144*, p. [2] (emphasis in original).

36 *Submission 34*, paragraph 132.

37 *Submission 34*, paragraph 133.

> Trees. They were subsequently purchased by a Singaporean Consortium, Olam Foods, who have just had their first successful harvest. Meanwhile we are left with nothing except the debt, which has increased nearly 200%. We purchased a product, that product was taken from us and sold to another, so while the new owners receive the profits, we are now being hounded to pay for the product we never got.[38]

15.35 Indeed, a common complaint levelled against the liquidators of MIS projects was that assets were sold at below their market value.[39] For example, Mr Trevor Burdon, an investor in Willmott Forests 2000 and in Gunns Plantations, witnessed PPB Liquidators disclaim viable pine assets and sell them at fire-sale for no net return or a very poor return. As noted earlier, however, the liquidators conducted a competitive sale process for WFL scheme assets and 'sold the assets for the best price obtainable in a sale process which was approved by the Supreme Court of Victoria'.[40]

15.36 KordaMentha also referred to the significant level of court oversight of the insolvencies as they attempted 'to navigate the complexities inherent in realising (and distributing the proceeds of) MIS related assets'. It stated:

> The material prepared for the courts during these and other MIS related engagments, and the resultant judgements, has provided clarity for stakeholders that will presumably inform the structure of any future projects and bring into sharp focus the risks associated with these types of tax-effective investments where little of a capital nature is acquired by Growers.
>
> In addition, the issues faced in realising the assets has highlighted a number of areas of possible regulatory change.[41]

15.37 In KordaMentha's view, CAMAC had undertaken valuable work in this area of insolvency and agribusiness MIS.[42]

Landlords

15.38 ASIC spoke not only of the competing interests of the secured creditors and the growers but of the owners of property who leased their land to the schemes and who also have a vital concern in the winding up of a failed MIS. Referring to landowners and their status as creditor, Mr Steel, Rural Affairs Manager, TGFA, noted that identifying the rights among a range of conflicting interests was one of the difficulties unravelling some of the complexity associated with agribusiness MIS. He said:

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38 Name withheld, *Submission 95*, p. [2].

39 *Confidential Submission 140*, p. 1.

40 Response from PPB Advisory to *Submission 187*, received 6 February 2015, p. 4.

41 Additional information provided on 4 December 2014, paragraphs 18–19, p. 7.

42 Additional information provided on 4 December 2014, paragraphs 19–21, p. 7.

> We are still unsure whether the landowners are creditors of GPL [Gunns] as the entity or of the individual schemes. If the latter, there is potential that they might get back-rent. But the liquidator has put options to the landowner which, in most cases, will cancel out any back-rent. So that is probably better for the grower-investor. That is another issue: you have got a liquidator who is looking after two interests. One of those interests is the landowner and the other is the grower-investor. So which one are they actually looking after? In our interests, it would have been better to have separate liquidators looking after the entities themselves so you know that they are actually looking after your interests and not looking over their shoulder. That is still going ahead.[43]

15.39 Mr Jim Crowley, whose property is surrounded by plantation developed land through an MIS, noted the difficulty he was having identifying the current owner of the property.[44]

15.40 KordaMentha informed the committee that it supported CAMAC's proposed regulatory reforms to the extent they would 'streamline the process and reduce the complexity for stakeholders in distressed MIS'. In its assessment, 'the benefits of any changes of this type would clearly extend to reduce the burden on landowners with distressed MIS plantations on their land and the wider rural communities'.[45]

Multi-function REs

15.41 According to CAMAC, another important distinction to be drawn when dealing with a financially stressed MIS was between sole-function REs and multi-function REs. In this regard, it noted that there was the potential for complexity where schemes were run by multi-function REs. It noted that:

> …the task of administering an insolvent multi-function RE can be made more difficult by having to disentangle its own dealings in its personal capacity from its dealings as operator of a number of schemes, and then determine which dealings as scheme operator go with which schemes. This process can be further complicated by disputation amongst a range of affected parties about the nature of their rights and remedies where the RE fails.
>
> This potentially complex untangling task would not arise if schemes could be operated only by sole-function REs.[46]

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43 *Proof Committee Hansard*, 5 August 2015, p. 19.

44 *Submission 7*, p. [1].

45 KordaMentha, additional information provided on 4 December 2014, paragraph 21.

46 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, p. 11.

15.42 The difficulties facing external administrators when attempting to reconcile competing interests means that they often resort to the courts for direction as demonstrated by the experiences of PPB Advisory and KordaMentha.[47]

Call for reform

15.43 Mr Carl Möller, member of the Victorian Bar, commented on the reliance on the courts for guidance when winding-up an agribusiness MIS. He wrote that when a company goes into voluntary administration or liquidation, it was usual for the relevant administration to be conducted without a court's involvement. He noted, however, that the opposite applied in respect of MIS and applications to the courts were common, observing that:

> The time, expense and effort in such applications are extraordinary.[48]

15.44 Overall, according to Mr Möller, MIS 'have not coped well with the challenges of insolvency' due in the main to 'the absence of a comprehensive regime governing how schemes should be wound up'.[49] Likewise, the Australian Restructuring Insolvency & Turnaround Association noted the extensive case law on forestry schemes that clearly point to the 'complex and unsatisfactory nature of the law'.[50] It referred to the insolvency practitioners involved in the administration of Willmott Forests, Great Southern, FEA applying to the courts for guidance and directions on how Chapter 5 of the Corporations Act (external administration) operates in respect of these schemes.[51] It also noted that many decisions of liquidators have been strongly contested in the courts, including the High Court.[52]

15.45 Similarly, ANZ identified the need to reform the insolvency regime that applied to MIS, urging the committee to 'press for reforms' in this area which may 'benefit future scheme investors'. It cited the findings of the CAMAC report on MIS, mentioning, in particular, to the issue of 'restructuring financially distressed schemes via the introduction of a voluntary administration scheme of the kind that applies to companies'.[53] Noting that currently there was no voluntary administration procedure available for MIS, KordaMentha also referred to the findings of CAMAC.[54] As

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47 See, for example, paragraphs 15.14–15.19 and 15.35.

48 Carl Möller, 'How have Managed Investment Schemes coped with the Challenges of Insolvency', in Stewart J. Madison (ed), *Insolvent Investments*, LexisNexis, Butterworths, Australia, 2015, paragraph, 2.81, p. 30.

49 Carl Möller, 'How have Managed Investment Schemes coped with the Challenges of Insolvency', in Stewart J. Madison (ed), *Insolvent Investments*, LexisNexis, Butterworths, Australia, 2015, paragraph 2.95, p. 33.

50 *Submission 23*, p. 1.

51 *Submission 23*, p. 2.

52 *Submission 23*, p. 2.

53 *Submission 145*, paragraphs 21–23.

54 KordaMentha, additional information provided on 4 December 2014, paragraph 20, p. 7.

mentioned earlier, KordaMentha supported CAMAC's proposed regulatory changes with regard to 'the procedures for restructuring financially distressed schemes, and winding up schemes where restructure is not possible, to the extent they would streamline the process and reduce the complexity for stakeholders in distressed MIS'.[55]

CAMAC's recommendations

15.46 CAMAC's very thorough examination of managed investment schemes enabled it to identify potential areas for reform.[56] It produced many recommendations that would address weaknesses when it comes to dealing with a financially stressed agribusiness MIS and if necessary the winding up of such a company.[57] Importantly, it noted:

> Much of the complexity, disputation, delay and costs that have surrounded the external administration of some common enterprise schemes in recent years can be traced to earlier failure by REs to ensure:
>
> - adequate separation and recording of the affairs of each of the schemes that they operate; and
> - clear identification of scheme property and its separation from the proprietary interests of scheme members utilised in the schemes.[58]

15.47 CAMAC formed the view, however, that it may not have been possible for the Corporations Act introduced in 1998 to 'anticipate the extent to which schemes would continue to develop beyond primarily passive pooled investment vehicles'. It noted that MIS now 'encompass large business enterprises, adopting the common enterprise scheme structure for taxation and other reasons'.[59] It recommended that while it might not be practical to require the redesign or termination of existing common enterprise schemes, there was 'considerable merit in forestalling future problems through a legislative initiative to prohibit the creation of new common enterprise schemes'.[60]

15.48 As noted earlier, ANZ, KordaMentha and ASIC supported the findings of CAMAC. The Australian Restructuring Insolvency & Turnaround Association also

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55 KordaMentha, additional information provided on 4 December 2014, paragraph 21, p. 7.

56 *Submission 34*, paragraph 122.

57 See Appendix 3 for a complete list of CAMAC's recommendations.

58 Corporations and Markets Advisory Committee, *Managed Investment Schemes* Report, July 2012, p. 59, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 9 June 2015).

59 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, p. 10, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 9 June 2015).

60 Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, p.11, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 9 June 2015).

referred to the number of law reform recommendations proposed by CAMAC that would serve to address a range of legal and other difficulties with the operation, regulation and winding up of schemes under Chapter 5C of the Corporations Act (managed investment schemes).[61] The FSI similarly recognised the work of CAMAC and briefly referred to the difficulties CAMAC identified in managing schemes in financial distress and the consequent consumer harm. It recommended that the government review CAMAC's recommendations, giving priority to matters such as those relating to consumer detriment, including illiquid schemes and freezing of funds.[62]

Conclusion

15.49 Unquestionably, the winding up of agribusiness MIS has encountered many practical difficulties not contemplated by current legislation. Indeed, the collapse and liquidation of some high-profile agribusiness MIS exposed the difficulties finding a replacement RE and the complexities in disentangling the rights and obligations of the various parties. It is clear that legislative change is required: that this area of the law is crying out for reform.

15.50 Clearly, CAMAC has prepared the ground work for more concrete action. The committee is strongly of the view that the valuable work produced by CAMAC in respect of the managed investment schemes especially the very difficult problems of dealing with MIS companies in financial stress provides an ideal starting point for reform.

Recommendation 20

15.51 The committee recommends that the government use CAMAC's report on managed investment schemes as the platform for further discussion and consultation with the industry with a view to introducing legislative reforms that would remedy the identified shortcomings in managing an MIS in financial difficulties and the winding-up of collapsed schemes.

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61 *Submission 23*, p. [1].

62 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 273, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

Chapter 16

Environmental and farming community concerns

16.1 The committee's main focus has been on the collapse of some of the large agribusiness MIS and their effect on retail investors. In this chapter, the committee turns its attention to farmers and landowners who had leased their land to an agribusiness scheme and to the environment and communities affected by the activity of agribusiness MIS including when a scheme failed. It considers the consequences for the agribusiness sector, particularly the forestry industry, and the future prospects for, and possible role of, agribusiness MIS in Australia.

16.2 Mr Hirst informed the committee that farmers, as landowners, certainly jumped at the opportunity to be involved in the MIS industry. Ms Davis noted that the farmers regarded leasing their property to an MIS as a business proposition on the basis of a standard business lease. She explained that from the farmers' perspective they were providing a service 'as simple as mowing the lawn':

> We have leased you our land, you grow your trees. Get on with it. It pays the rent and it is a straight business transaction.[1]

16.3 Experiences have shown, however, that the agreements with landowners were not straightforward and the consequences stemming from a failed scheme have been far reaching.

Environmental and social consequences

16.4 Mr Sean Cadman from the Cadman and Norwood Environmental Consultancy informed the committee that:

> In 1990 the National Plantations Advisory Committee was established to investigate the opportunities for integrating forestry and farming commercial wood production on cleared agricultural land.[2]

16.5 The advisory committee was to examine sustainable opportunities for expanding Australia's plantation estate. Mr Cadman, who represented the Australian Conservation Foundation on that committee, highlighted the importance of understanding that:

> …as early as 1990 there was recognition in the terms and references of the committee and in the reports that were undertaken to inform the recommendations of the committee, that a poorly managed rollout of a

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1 *Proof Committee Hansard*, 5 August 2015, p. 25.

2 *Submission 105*, p. [1].

> plantation development agenda could lead to very perverse outcomes for the environment and the long term sustainability of an Australian plantation estate.[3]

16.6 According to Mr Cadman, specific concerns were raised, or advice given, at that time including, but not limited to:

- plantation establishment should NOT drive land clearing;
- the taxation treatment of the time was a disincentive to investment because the tax all fell due at the point of harvest;
- any taxation changes to incentivise plantation should not become an end in themselves and plantation establishment needed to be based on business models that did not require the continuation of tax deductibility for the business model to succeed;
- specifically that taxation incentives needed to be phased down to zero over a 10 year period;
- to be sustainable plantations needed to be established to provide inputs to industrial processing plants and that just growing for wood chips for exports was unlikely to be sustainable;
- site selection should be based on realistic growth rates, specifically that the costs of pest control should not be underestimated and that rainfall and soil parameters need to be within a certain range or economic growth rates would not be realised (CSIRO modelled the sites in Australia that would be most likely to succeed); and
- communities needed to benefit clearly from any large plantation establishment program because of negative community experiences in the past.[4]

16.7 Researchers similarly warned of the potential that, eventually, the benefits of investor tax concessions could 'show up as subsidies to higher cost structure operations and/or returns to operators of such schemes, rather than inducing expansion of efficient investment'. They cited numerous complaints about the harmful effect of agribusiness MIS schemes on traditional farming activities, including 'giving an artificial tax-induced boost to agricultural land prices'.[5]

16.8 Evidence before the committee clearly shows that the concerns identified in the 1990s were justifiable and ultimately, in many cases, the failure to heed them

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3 *Submission 105*, p. [1].

4 *Submission 105*, pp. [1]–[2].

5 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 11, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (accessed 9 December 2014).

contributed to the downfall of some very prominent MIS with wide ranging environmental consequences.

Damage to environment and reputation of agribusiness MIS

16.9 Mr Cadman referred to the collapse of the schemes and the high probability that most of the lots would be 'cleared and revert to either agricultural production or become derelict weed-scapes'. He also noted the concomitant destruction of faith in the forestry sector, observing:

> Hundreds of thousands of hectares of land was cleared in Tasmania and on the Tiwi Islands at a huge environmental cost. The Australian Public has almost nothing to show for the millions of dollars of tax incentives given and gullible investors pursued by unscrupulous financial advisors have lost millions.[6]

16.10 Likewise, the TFGA lamented the aftermath of the failure of some schemes, noting that many plantations have died or stopped growing while others have received little or no ongoing maintenance. It stated:

> In the specific case of the forestry schemes, there have been a raft of perverse and detrimental outcomes which have been magnified by the collapse of Gunns Ltd. Many private landowners who had arrangements with Gunns have now been left with a devastating economic and emotional legacy. Coupled with the impacts of significant sovereign risk as a result of government decisions, this leaves scars that will ensure that further plantation expansion and replanting on private land will be limited if non-existent. Many have been so adversely affected that the thought of planting another tree on their property is too much to bear.[7]

16.11 In the association's assessment:

> Much of the original speculation with the MIS plantation arrangements within Tasmania was that the estate would become a resource for downstream processing. The main component of this was promoted to be the proposed Tamar Valley pulp mill, with other minor processing options adding to the overall industry. In hindsight, the reliance on one project, and the establishment of vast plantations to feed it, was clearly strategically poor. Silver bullet solutions rarely work. The schemes should have been accompanied by concise research on what other options were available for downstream processing. Had that been the case, then in the process a natural diversification of options would have been developed. This would have ensured that the failure of one project and or company would not have put at risk a whole industry.[8]

6 *Submission 105*, p. [3].

7 *Submission 24*, p. 4.

8 *Submission 24*, p. 5.

16.12 Noting one of the key underpinnings of the forestry MIS—to enhance investment with the objective of increasing the area of commercial trees to levels that were not being met by normal market forces—the TFGA explained:

> The idea was that allowing tax deductions would enhance this objective; and at the same time provide a valuable timber source into the future. While it is debatable that such a market failure was real, the fact remains that we now find ourselves in a situation where the bulk of the plantation estate in Tasmania is an asset that is rapidly collapsing.[9]

16.13 Mr Lawrence, an economist, tax accountant and more recently a public policy researcher, was critical of the ATO for failing to monitor the schemes once they were established to ensure they were being run in accordance with the product ruling. He recalled visiting plantations where 'trees had died, cattle were in there, horses were in there'.[10] Mr Jim Crowley, whose property is surrounded by plantation developed land through an MIS, also drew attention to:

- no demonstrated responsibility for the on-going maintenance of shared boundary fences;
- no maintenance of fire-breaks;
- no weed or wallaby control;
- an increased fear of fire [the plantation land was previously cleared pasture]; and
- massive irritation that my 'neighbour' does not pay council rates.[11]

16.14 Similarly, Mr Paton listed the by-products of forestry MIS and related schemes, which included:

- vast tracts of land in Western Australia, Victoria and South Australia now converted back to pasture because of failed plantations;
- huge kangaroo plagues in the Albany, Great Southern region of Western Australia and the Green Triangle region in Victoria/South Australia; and
- local community dislocation in townships such as Hamilton, where huge flurries of investment activity initially occurred, distorting land values, artificially ratcheting farm rentals and taking high value farmland out of production into passive monocultures such as Blue Gums.[12]

9 *Submission 24*, p. 4.

10 *Proof Committee Hansard*, 5 August 2015, pp. 3 and 4.

11 *Submission 7*, p. [1].

12 *Submission 149*, p. 5.

The committee visited a plantation outside Launceston. In this instance, the failure of the FMIS led to the foreclosure and sale of the property. The visit also provided an example of where tree growth rates did not meet the expectations outlined in the prospectus.

16.15 In Mr Paton's view, agribusiness MIS should be 'shut down once and for all in every aspect'.[13] In contrast, however, some submitters envisaged a promising future for such schemes. Even so, they recognised that changes were required.

16.16 Clearly, forestry MIS failed to achieve the overriding strategic goals of *2020 Vision*—to have a plantation industry with a sound reputation as a credible investment destination and to have 'well-informed investors willingly participating in well-run and profitable managed investment plantations projects'.[14] The collapse of a number of significant agribusiness MIS companies has severely undermined investor confidence in such schemes. According to NewForests:

> With major MIS companies being liquidated and most MIS investors losing much of their investment, it is unlikely that the sector will ever recover. The opportunity for institutional investors is to rationalize the land and forestry assets—1 million hectares of timber plantation—into a consolidated timberland asset.[15]

16.17 As noted in chapter 2, since the introduction of MIS in 1998, agribusiness schemes have raised approximately $8 billion. To appreciate the magnitude of the financial loss that stemmed from failed agribusiness MIS, the particular schemes that have collapsed raised:

- Timbercorp, just over $1 billion;
- Great Southern, $1.8 billion;
- FEA Plantations, $426 million;
- Rewards Projects Limited, $291 million;
- Willmott Forests, about $400 million; and
- Gunns Plantations, about $1.8 billion.[16]

16.18 A number of major participants in agribusiness, but particularly in the forestry sector, argued, however, that the aims and objectives spelt out in *2020 Vision* remain valid. They recognised the significant contribution that the Australian forestry industry currently makes to Australia's overall economic development.[17]

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13 *Submission 149*, p. 6.

14 *Plantations for Australia: The 2020 Vision*, an Industry/Government Initiative for Plantation Forestry in Australia, p. 15, http://www.agriculture.gov.au/Style%20Library/Images/DAFF/__data/assets/pdffile/0009/2398185/plantations-australia-2020-vision.pdf

15 NewForests, 'Rationalizing Timberland Managed Investment Schemes: The changing Landscape of Australia's Forestry Investment Sector', p. 1, http://www.newforests.com.au/wp-content/uploads/2014/09/Rationalizing-the-MIS-20140908.pdf (accessed 15 November 2014).

16 *Proof Committee Hansard*, 14 October 2015, p. 18.

17 AgriWealth, *Submission 138*, p. 1.

Viability of schemes after liquidation and sale

16.19 Mr Ian Farquhar, Tasmanian farmer, informed the committee that in his opinion the underlying motives for the schemes remain valid, which were to address two needs:

- to return more trees to the Australian landscape—although, in his view, MIS may not be the most appropriate vehicle to meet this need of rural landscape management; and
- to remedy the significant deficiency in the long term base capital in Australian primary industry.[18]

16.20 According to Mr Farquhar:

> The MIS successfully identified an availability of funds in our cities for investment in primary industry. It is unfortunate the MIS structure attracted many who primarily sought to avoid taxation rather than invest in rural business.[19]

16.21 Mr Farquhar noted that 'a few well managed businesses have demonstrated that this vehicle can be used to develop successful, productive enterprises'.[20] Likewise, Mr Bryant suggested that MIS:

> As a form of investment…are important to the growth of this country. It goes to the heart of what regulation there is around entities being able to do business in this country. That is what has gone wrong here. The regulation around how Timbercorp could operate and grow to the size it did was clearly inadequate.[21]

16.22 Since the collapse of Australia's major agribusiness MIS in 2009 and 2010, Timberland Investment Management Organisations (TIMOs) have purchased a significant area of the MIS plantation estate. The Department of Agriculture informed the committee that, while the trend in MIS investments was based mostly on individual investors, after 2009:

> …the majority of the MIS companies which have gone into receivership and liquidation have had their assets purchased by a small number of TIMOs backed by institutional investors. The institutional investors were generally offshore superannuation funds, pension funds, university endowments, foundations, hedge funds, as well as high net worth individuals and families.[22]

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18 *Submission 3*, p. 1.

19 *Submission 3*, p. 2.

20 *Submission 3*, p. 2.

21 *Proof Committee Hansard*, 12 November 2014, pp. 30–31.

22 *Submission 135*, p. 6.

16.23 The liquidators of the Timbercorp Group, KordaMentha, informed the committee that while the schemes did not continue, the 'sale assets to well-resourced operators was ultimately to the benefit of the industries and communities of which they were a part'.[23] It noted that similar to the restructure of the olive asset, there has been:

> …the sale of the assets relating to the forestry, almond, citrus and table grape MIS to operators with the financial capacity to properly maintain and harvest the crops, and provide employment opportunities in rural communities, into the future.[24]

16.24 Likewise, the ANZ informed the committee that the underlying agricultural plantations sold by the Timbercorp liquidator were operating successfully 'after market conditions improved and the drought broke'.[25]

Reforming the system

16.25 The Australian Forest Products Association also acknowledged the damaging and disruptive effects of the collapse of many forestry MIS companies on investors and across the broader plantation forest products industry.[26] It formed the view, however, that 'subject to appropriate standards of due diligence and corporate governance, the MIS structure and plantation taxation arrangement should continue to be available to support new plantation investment'.[27] It referred to an issue that had been raised previously, but not addressed by changes to the tax act following the Plantation Taxation Review—the appropriateness of the upfront fee model used by most forestry MIS companies for projects that have a lifespan of 10 years. It stated:

> While the main costs associated with a forestry MIS project are incurred in the first three years, related to plantation establishment, including forming access roads, site preparation, tree planting and clearing of competing vegetation, there are also some ongoing costs, such as lease payments for land, maintaining fire breaks and monitoring for pests and disease. Given the financial challenges faced by many major forestry MIS companies following the GFC, questions were asked as to whether forestry MIS companies maintained sufficient cash reserves to cover these ongoing costs.[28]

16.26 According to the Australian Forest Products Association such concerns and doubts about the viability of established forestry MIS projects could be addressed. It proposed that forestry MIS companies that accept upfront payments from retail

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23 KordaMentha, additional information provided on 4 December 2014, paragraph 19.

24 KordaMentha, additional information provided on 4 December 2014, paragraph 21.

25 *Submission 145*, paragraph 19.

26 *Submission 126*, p. 2.

27 *Submission 126*, p. 2.

28 *Submission 126*, p. 17.

investors to cover the life of a project 'be encouraged to maintain a reserve account, with sufficient funds held in trust to cover any ongoing costs'. As an alternative, it suggested that companies managing retail forestry MIS projects 'be encouraged to adjust their fee model, to involve a large initial payment to cover plantation establishment, as well as a small annual payment to cover ongoing costs such as land lease payments'.[29]

16.27 Addressing the particular matter of long-rotation crop, Ms Davis noted that any future tax concessions need to be considered 'really long and hard'. In her view, if there were to be tax concessions, they needed 'to be targeted to the production, not to the tax benefit that comes out at the end'. In essence, they would need 'to be much more agriculturally focused than commercial-output driven at the end'.[30]

16.28 Trees Victoria also argued that despite the disappointing performance of a number of MIS, the 'model still has merit and it should not be a case of "throw the baby out with the bath water"'. It noted that the key driver for new plantations is Australia's need to expand its commercial forest plantation estate to meet the forecast future demand for timber and related products.[31] Trees Australia observed that in the wake of the MIS collapses, most new entrants were not interested in establishing new plantations because they understood the schemes were 'too risky' and the returns not sufficiently high. It noted that current interest was directed at purchasing and managing the established MIS estate and 'reaping the rewards of picking up a distressed asset'.[32]

16.29 Based on its experience in the forestry business, Trees Australia recognised the 'difficulty of having any organisation invest in the establishment of new plantations, without a tangible incentive'.[33] It explained that the managers of both government and the larger privately owned plantations have problems finding the funds to re-establish harvested plantations let alone expand into new areas, and further:

> The 'missing link' is investment in the creation of the plantation and development in the early years. **MIS is and must remain one of the mechanisms for creating new forestry managed investments in Australia**.[34]

16.30 Overall, Trees Victoria argued that, with improvements to procedures and better targeting of appropriate investors, the basic MIS concept has 'a valid and

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29 *Submission 126*, p. 17.

30 *Proof Committee Hansard*, 5 August 2015, p. 26.

31 *Submission 137*, p. 1.

32 *Submission 137*, pp. 1–2.

33 *Submission 137*, p. 2.

34 *Submission 137*, p. 2, (emphasis in original).

important role to play in the future development of new plantations'.[35] It recognised that the taxation incentive was a very important factor in attracting investors and should be 'fine tuned' in order 'to increase the pool of sophisticated investors who will invest in the long rotations plantations'. Trees Victoria cautioned that legislation should not generate unintended consequences and suggested:

> The initial focus of MIS on short rotation eucalypt timbers largely for export has been shown to be the wrong direction. For long term (25 years plus) forestry investments, such as softwood plantations being grown for sawlogs, the missing link may be the first 15 years of the plantation. Once a softwood plantation is around 15 years old and been thinned, and is a well-managed plantation in a location where there are stable long term timber markets, then those plantations become attractive to the kind of companies which have purchased the large scale forestry plantation assets in Australia over the past 10 years or so.[36]

16.31 AgriWealth also contended that there was nothing wrong with granting a tax deduction to plant trees. It rejected the notion that the recent MIS collapses arose because the legislation allowed an investor a tax deduction to plant trees. It argued that the collapses arose because of the mismanagement by those entrusted with the responsibility to manage the respective plantations properly. It also observed that recently institutional investors were 'primarily acquiring the plantations established by the failed MIS companies'. It reasoned that:

> Those same plantations will deliver significant profits to their purchasers. There is nothing wrong with the plantations—only those who could not carry out their stewardship in a commercially responsible manner. The tax incentive was offered so as to attract capital into establishing plantation timber—the incentive achieved its actual purpose.[37]

16.32 Recognising that many of the individuals who invested in MIS suffered significant financial losses, AgriWealth suggested tightening regulation around the actions of financial advisers, including better disclosure, or alternatively restricting the offer of MIS to wholesale investors only.[38] AgriWealth noted:

> Forestry MIS projects form an integral part of plantation timber production. Whilst institutional investors participate in the forestry/timber sector they generally enter the sector after establishment risk has been eliminated. For example, in relation to long-term saw log timber institutions generally enter the market when the trees are around 15 years of age. At this time the institutions are able to more accurately determine the growth rate of timber for each specific plantation and therefore the relevant purchase price. Their entry occurs after establishment risk has passed.

35 *Submission 137*, p. 2.

36 *Submission 137*, pp. 3–4.

37 *Submission 138*, p. 2.

38 *Submission 138*, p. 2.

> Institutional investors will not replace individual investors in fulfilling the need to plant new plantations. Without incentives being offered to individual investors no new capital will be attracted to new plantation establishment other than from government.
>
> We consider that the forestry MIS sector is an important and valuable contributor to plantation establishment, production and the growth of carbon sequestration. The establishment of more plantation timber in Australia will benefit rural and regional employment, Australian GDP, Australian self sufficiency of saw log timber supply and allow Australian individual taxpayers exposure to a high performing asset class.[39]

16.33 Chartered Accountants Australia and New Zealand (CA) supported the concept of managed investment schemes as they provide 'an option to bring capital to rural Australia which would not otherwise occur'. It also noted other benefits such as increased employment opportunities. CA conceded, however, that aspects of the MIS appeared to 'skew parts of the industry and that the agribusiness industry grew to become larger than the intended objectives of the original model and structure'.[40] Given the apparent distortions caused by MIS schemes, CA suggested that arguably the schemes 'should only be allowed where there is a national interest element, such as becoming self-sufficient in wood pulp production, or preventing the destruction of rainforest in other countries'.[41]

16.34 TFS, the biggest sandalwood grower and manager of Indian Sandalwood in the world, has transitioned from 'a pure MIS operator to a more diversified business including Sandalwood production and marketing and an institutional investment programme'.[42] In recent years, it has diversified its funding base to include institutional investors, arguing that:

> …this mix of Institutional and MIS investment is a reciprocal vindication of this forestry investment model and one that will ensure TFS' strength as it evolves into an industrial company in a truly Australian venture.[43]

16.35 According to TFS, while the MIS philosophy had, in many cases, been poorly implemented, the socio-economic aspirations that drove it were 'as valid today as they were at its inception'. In its own words:

> TFS has tried Forestry MIS and TFS has succeeded. Investors and rural communities have benefitted, and are benefitting from the TFS version of Forestry MIS.[44]

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39 *Submission 138*, p. 3.

40 *Submission 143*, p. 2.

41 *Submission 143*, p. 2.

42 *Submission 132*, p. 6.

43 *Submission 132*, p. 6.

44 *Submission 132*, p. 4.

16.36 Addressing the potential weakness of an up-front fee model, TFS has independently introduced measures whereby growers pay one year's management fees and rent up front. It noted that this measure:

> …allows for time to replace the responsible entity in the event of its failure. Similarly the registering of all leases on title provides a further measure to protect the interests of investors. These are measures that could be implemented more widely.[45]

Previous reviews

16.37 In 2005, the government undertook a review of the taxation policy of plantation forestry and, in 2008, conducted a review into non forestry MIS.[46] Since then, there have been major developments that have exposed flaws either in taxation policy and/or its implementation. Now, with the benefit of hindsight from the MIS collapses, the committee suggests it is time to examine the tax incentives and any unintended consequences that flowed from them. In particular, this proposed review should look at the extent to which the tax concessions created distortions.

Conclusion

16.38 The committee identified numerous factors that underpinned the failure of a number of high profile agribusiness MIS, which have caused significant damage to investors, to farmers, neighbouring communities as well as the overall reputation of agribusiness MIS. In this chapter, the focus was primarily on the implementation of the policy designed to attract capital into forestry schemes. There was, however, no single cause for the failure of a number of agribusiness MIS, but a combination of factors including those related to the overall policy designed to encourage investment in MIS:

- poorly managed implementation of the policy objective;
- inadequate tracking of, and reporting on, project performance resulting in poor quality information available to investors and policy makers; and
- poor monitoring and understanding of the tax incentives and whether they were having unintended adverse effects, such as investment in non-commercially viable products or inflating up-front costs.

16.39 As noted earlier, the MIS structure has a number of advantages particularly the pooling of investment funds to achieve economies of scale. Should the

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45 *Submission 132*, p. 5.

46 In the 2005–06 Budget, the government announced that it would conduct a review of the application of taxation law to plantation forestry in the context of the government's broader plantation and natural resource management policies, Treasury, *Review of Taxation Treatment of Plantation Forestry*, 22 June 2005, http://archive.treasury.gov.au/contentitem.asp?ContentID=997&NavID (accessed 22 September 2015).

government determine that agribusiness or forestry MIS warrant continued government support, then important lessons must be drawn from the MIS failures. First and foremost, policy makers must have before them solid research on, and analysis of, the operation of tax incentives offered for agribusiness MIS.

Recommendation 21

16.40 The committee notes that neither the ATO nor Treasury have undertaken a comprehensive review of the tax incentives for MIS and whether they had unintended consequences such as diverting funds away from more productive enterprises; inflating up front expenses; or encouraging poorly-researched management decisions (planting in unsuitable locations). The committee recommends that Treasury commission a review to better inform the policy around providing tax concessions for agribusiness MIS.

Recommendation 22

16.41 The committee recommends further that the proposed review consider the approach to the incentives offered to investors in agribusiness ventures by other countries such as the United Kingdom to inform the review's findings and recommendations.

Recommendation 23

16.42 In addition to the above recommendation, the committee recommends that the government request the Productivity Commission to inquire into and report on the use of taxation incentives in agribusiness MIS. As part of its inquiry, the Productivity Commission should identify the unintended adverse consequences, if any, that flowed from allowing tax deductions for agribusiness MIS. For example:

- **the potential for mis-selling financial products on the tax concessions;**
- **the incentive for retail investors to borrow, sometimes unwisely, to fund their investment;**
- **whether the taxation concessions:**
  - **became an end in themselves rather than the business model;**
  - **showed up as subsidies to higher cost structures, operations and/or returns to the operators of the schemes; and**
  - **distorted land values and diverted high value farmland into passive monoculture such as Blue Gums.**

16.43 The main purpose of the inquiry would be to draw not only on the experiences of the failed MIS but also the successful schemes to determine whether there is merit in reforming the system of tax incentives and, if so, what those reforms should be.

Chapter 17

Compensation

> In his determination of our case the Financial Ombudsman directed our Financial Adviser to pay many hundreds of thousands of dollars to us but we received nothing as the company was in liquidation and the directors were all bankrupt. The company's professional indemnity insurance was pathetically inadequate and had long been exhausted.[1]

17.1 Investors caught up in the collapse of the MIS found that they had few if any available or affordable avenues to seek some form of restitution for bad advice and/or irresponsible lending practices. In this chapter, the committee examines the compensation mechanisms available to investors who, through poor advice or misleading promotion, have suffered financial loss.

Avenues for recompense

17.2 ASIC maintained that:

> Having efficient and effective dispute resolution and compensation mechanisms is integral to promoting the confident and informed participation of consumers in the Australian financial services system…[2]

17.3 The experiences of numerous retail investors in agribusiness MIS, however, exposed deficiencies in the mechanisms meant to provide redress for breaches of the law. For example, one couple stated that there was no recourse for the average investor, explaining:

> Lawyers' fees are hundreds and thousands of dollars. ASIC have done nothing. The Financial Ombudsman does nothing. What do we have left? Our voice now is through the press and imploring you, who are a representative of the people of Australia, to do something.[3]

17.4 Along similar lines, Greig and Bridget Allan noted that there was no compensation for small investors in the collapse of forestry MIS and other agricultural schemes. In their view:

> Litigation is fraught with expenses beyond the limits of small investors. Banks have enormous resources to see that all loans are paid in full for collapsed schemes.[4]

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1 Name withheld, *Submission 186*, p. 4.

2 *Submission 34*, paragraph 165.

3 Name withheld, *Submission 56*, p. [5].

4 *Submission 133*, p. [1].

17.5 An investment manager who has been attempting to assist a number of clients with investments in early Timbercorp forestry projects, Mr Jeff Chin, joined many other investors to highlight the difficulties investors have in seeking recompense for perceived shortcomings:

> The difficulties for growers in simply defending the claims in court include inexperience and the extremely high cost of access to justice. In some cases, it simply cannot be financed, whereas in others, the cost is disproportionately large and many multiples of the amounts in question (which is typical of the reason that the consumer protections were put in place in the first instance)…The Liquidators appear to be gaming this with their preference for the unduly legal approach and refusal to discuss.[5]

17.6 In his assessment, the most serious allegations appeared to involve breaches of existing regulations that centre on intermediaries who are bankrupt or have been in bankruptcy. According to Mr Chin, 'the issue is not that current regulations do not already prohibit such behaviour, it is that perpetrators simply ignore the existing requirements and there does not appear to be adequate compensatory arrangements in place'.[6]

Advisers—professional indemnity insurance and bankruptcy

17.7 ASIC noted that AFS licensees must have adequate arrangements for compensating retail clients and consumers for loss or damage due to breaches of the financial services laws and explained the compensation arrangements. For example, the Corporate Regulations 2001 mandate that an AFS licensee must have an 'acceptable contract' of professional indemnity (PI) insurance as 'the key form of compensation'.[7] According to ASIC, this PI insurance cover is required to:

a) be adequate, having regard to the licensee's business (the volume of business, the number and kinds of clients or consumers, the kind of business and the number of representatives) and the maximum liability to compensation claims that realistically might arise;

b) cover external dispute resolution (EDRs) scheme awards—currently, two ASIC-approved EDR schemes operate—the Financial Ombudsman Service (FOS) and the Credit and Investments Ombudsman (CIO);

c) cover fraud or dishonesty by directors, employees, other representatives and other agents of the licensee; and

5 *Submission 144*, p. [2].

6 *Submission 144*, p. [2].

7 *Submission 34*, paragraphs 181–182.

d) have a limit of at least $2 million for any one claim and in the aggregate for licensees with total revenue from financial services or credit services provided to retail clients and consumers of $2 million or less.[8]

17.8 PI insurance, however, has its drawbacks. ASIC noted that this insurance is designed to protect AFS licensees against business risk, but not to provide compensation directly to investors and financial consumers, explaining further:

> It is a means of reducing the risk that a licensee cannot pay claims because of insufficient financial resources, but has some significant limitations, including where there are insolvency issues, or multiple claims against a single licensee. In addition, directors may access PI insurance to defend legal proceedings, which may reduce the amount available for investors.[9]

17.9 According to ASIC, the gaps in, and caps on, PI insurance cover will 'inevitably remain a problem', given the limits on ASIC's capacity 'to compel commercial providers of the product to adapt it to a purpose different from and beyond the purpose for which it was designed'.[10]

17.10 Evidence to this inquiry highlighted the inadequacy of PI insurance for some of the financial advisers who recommended agribusiness MIS to their retail clients. A number of investors referred to their financial adviser opting to declare bankruptcy, thereby closing off any means for them to recoup losses they believed resulted from inappropriate advice or their adviser's misconduct. Indeed, by declaring bankruptcy, the adviser escaped litigation and left clients unable to recover their losses.[11]

17.11 Invariably, investors looking to receive compensation from their adviser for poor financial advice were disappointed. One such investor stated:

> The adviser had insurance but it was not enough to cover all the people suing them and they declared bankruptcy leaving us with no avenue for compensation. Our last resort is this class action against Bendigo/Adelaide bank. We started off with an unencumbered home and now we are in over one million dollars of debt with only one income and a young, growing family.[12]

17.12 Their account is similar to many others, who referred to the inadequacy of professional indemnity insurance.[13] A number of growers noted that the professional

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8 *Submission 34*, paragraph 184.

9 *Submission 34*, paragraph 186.

10 *Submission 34*, paragraph 187.

11 *Confidential Submission 116*, p. [1].

12 Mr Andigone Aguilar, *Submission 67*, p. 1.

13 Ms Michelle Johnson, *Submission 139*, p. [1]; name withheld, *Submission 168*.

indemnity their financial services provider had taken out was 'hopelessly inadequate'.[14] For example, one investor stated:

> Our Financial Planner was massively under-insured and he himself declared bankruptcy to avoid litigation to recover costs against him. We are left with no financial recourse against the financial planner and the legal avenues against the banks seem to be fruitless despite clear evidence of knowledge of the non-viability of the schemes they were funding.[15]

17.13 Another investor, referred to her adviser, Mr Holt, stating that it was hard to believe that he was allowed to trade with only a $2 million PI insurance policy for his business, which proved totally inadequate for his clients. Effectively, the clients were denied the opportunity to take legal action to recoup some of their losses brought about by his poor financial advice.

17.14 A financial adviser without financial backing means that even when an investor has received a favourable award from the Financial Ombudsman Service (FOS), the investor may not receive compensation. FOS is one of the two ASIC-approved EDR schemes.[16]

17.15 The experiences of clients of Mr Steve Navra demonstrated clearly the limited opportunities for obtaining any form of restitution. One such client explained that after the first successful FOS claim against Mr Navra, Mr Navra immediately 'declared bankruptcy, relocated to Melbourne and is now practicing "wealth education" seminars down there'. He noted further:

> At the time of the Great Southern demise, we even received a letter from ASIC advising us we had potentially been mis-sold Grapevine products by Steve and to take [it] up with the Financial Ombudsman—but to what purpose? Steve is bankrupt, had insufficient insurance to cover all our claims…and with this 'settlement' we would no longer be able to pursue via FOS anyway.[17]

17.16 Another couple had a similar experience. They had received a letter from ASIC advising them that they may have been given inappropriate financial advice. They subsequently lodged claims for compensation through FOS only, in their words, 'to be let down'. They explained:

> Just as our case was about to go to determination our financial advisor declared bankruptcy. Subsequently we sought private legal advice, at great expense, and are still awaiting an outcome as it appears our financial

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14 *Confidential Submission 134,* p. [4]; Ms Michelle Johnson, *Submission 139,* p. [1]–[2].

15 *Confidential Submission 116,* p. [1].

16 The current regulatory architecture of the financial services complaints resolution system has its origins in the 1997 Wallis Inquiry, which identified the need for low-cost means to resolve disputes. See Financial Ombudsman Service, *Submission 193*, p. 3.

17 Name withheld, *Submission 56,* p. [4].

> advisor only had about $2 million insurance cover and the insurer is able to employ delay tactics until the statute of limitations is up or we give up.[18]

17.17 Noting that there was already a professional indemnity requirement, the FPA asserted that it was 'effectively broken'. It suggested that ASIC has no way to check PI cover: that there are no checks to make sure it is adequate.[19]

Compensation scheme

17.18 ASIC recognised that the effectiveness of the existing mechanism intended to compensate investors was limited where the ASF licensee 'is insolvent and the PI insurance is not responding'. Put bluntly:

> In these circumstances there is generally no realistic prospect of investors obtaining any compensation.[20]

17.19 One investor suggested the need for a special compensation scheme:

> The amount of debt and financial hardship this has directly caused hard working Australians, some sort of compensation package for Timbercorp victims needs to be addressed and set up as it has affected so many families and put them on the path to financial ruin.[21]

17.20 Another couple also suggested that help was needed to introduce a compensation package for victims of Timbercorp who received bad financial advice and whose projects were managed poorly. They added:

> We can't be fully compensated for our total loss, as there is no amount of money that can restore our trust or health.[22]

17.21 Clearly, the incidence of uncompensated loss for investors in agribusiness MIS undermines public confidence in Australia's financial services system and enlivens the debate about the merits of introducing a last resort compensation scheme.

Report on compensation arrangements

17.22 Industry Super Australia acknowledged that many of those who had suffered financial loss because of their investment in MIS had not received compensation. It believed there was value in considering the recommendations arising from Mr Richard St John's 2012 report. Although not specifically addressing investors in failed MIS, Mr St John's recommendations have relevance. They included:

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18 Name withheld, *Submission 65*, p. [1].

19 Mr Neil Kendall, *Proof Committee Hansard*, 6 August 2015, p. 29.

20 *Submission 34*, paragraph 192.

21 Name withheld, *Submission 33*, p. [2].

22 Name withheld, *Submission 102*, p. [2].

- require licensees to provide ASIC with additional assurance that their professional indemnity insurance cover is current and is adequate to their business needs;
- more attention should be given, on a risk targeted basis and in conjunction with the level of their insurance cover, to the adequacy of licensees' financial resources to enable better management of risks and unexpected costs such as compensation liabilities;
- ASIC should take a more pro-active approach in monitoring licensee compliance with the requirement to hold adequate professional indemnity insurance cover and any new requirement in regard to financial resources, and in targeting licensees who are most at risk;
- to assist ASIC in playing a more pro-active role in administering the licensing regime with respect to compensation arrangements, consideration should be given to clearer powers to enforce standards and to sanction licensees who do not comply;
- in dealing with licensees who give up their licence or reduce the scope of their licensed activities, ASIC should seek where possible to secure ongoing protection for retail clients including by imposing appropriate conditions in relation to the termination of a licence or the amalgamation or takeover of a licensed business; and
- given their role in the regime for the protection of consumers of financial services, and marked increases in their jurisdiction, External Dispute Resolution schemes and ASIC should give more attention to the adequacy of the EDR scheme processes as those schemes grow beyond their origins as forums for small claims.[23]

17.23 With regard to introducing a last resort compensation scheme, Mr St. John urged caution. In his view, such a move at this stage would not address the underlying problems: that it would 'be inappropriate, and possibly counter-productive'. He explained:

> A last resort scheme would have the effect of imposing on better capitalised and/or more responsibly managed licensees the cost of bailing out the obligations of failed licensees. It would not work to improve the standards of licensee behaviour or motivate a greater acceptance by licensees of responsibility for the consequences of their own conduct. It could well introduce an element of regulatory moral hazard by reducing incentive for

23 Richard St. John, *Compensation arrangements for consumers of financial services,* April 2012, pp. 147–149, http://futureofadvice.treasury.gov.au/content/consultation/compensation_arrangements_report/downloads/Final_Report_CACFS.pdf (accessed 1 June 2015). *Submission 136,* p. 5.

> stringent regulation or rigorous administration of the compensation arrangements.[24]

17.24 According to Mr St John, deferring further consideration of a last resort scheme would be preferable pending the implementation of the measures he had proposed as well as other reforms now in train including FOFA.

17.25 The committee touched on the inadequacy of compensation mechanism in its 2014 report and has again received, and taken evidence on, this matter in its scrutiny of financial advice inquiry (SOFA), particularly a proposal for a compensation scheme of last resort. For example, consistent with the evidence relating to agribusiness MIS, Mr Craig Meller, AMP told the SOFA inquiry that some providers in the industry do not have adequate insurance arrangements. He recognised that it would be appropriate to have some sort of underlying safety net for those who have slipped through the system—'those who got a FOS determination and then, for whatever reason, were unable to be remunerated from the provider of advice'.[25] Mr Meller suggested that in conjunction with any consideration of a compensation scheme, consideration should be given to determining what the minimum levels of indemnity insurance should be and ensuring they are appropriate. He did note, however, that there are cases where insurance is not available, for example, a business cannot get insurance for committing fraud. In AMP's view:

> …there should certainly be consideration that minimum capital requirements could be put in place, to ensure that the number of people who slipped through the safety net and were not remunerated could become *de minimis*. In that case, it would be much easier to build an industry coalition to find a way to cover such a compensation scheme.[26]

17.26 From her unique position as the independent hardship advocate (IHA), Ms Lowe had no doubt that a significant number of the people she was working with should receive compensation. She noted that at best the advice they received to invest in Timbercorp appeared 'completely inappropriate, at worst, deceitful', adding:

> It is equally clear that the protection mechanisms in place are not adequate to provide that compensation.[27]

17.27 Ms Lowe considered the avenues open to the victims of bad financial advice and concluded:

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24 Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 143, http://futureofadvice.treasury.gov.au/content/consultation/compensation_arrangements_report/downloads/Final_Report_CACFS.pdf (accessed 1 June 2015).

25 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 10 August 2015, 10 August 2015, p. 2.

26 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 10 August 2015, pp. 1–2.

27 Ms Catriona Lowe, *Submission 200*, paragraph 4.

> Whilst many victims of poor adviser conduct may well succeed in a complaint to either the Financial Ombudsman Service or Credit and Investments Ombudsman, a favourable determination must then be satisfied. Neither adviser solvency nor professional indemnity insurance has proved adequate to this task. In the case of PI, levels of cover are either woefully inadequate to compensate loss or too narrow in scope to answer at all. Experience in other insurance markets such as public liability and home building insurance suggest that endeavours to mandate scope or depth of PI will not succeed in the medium to long term.[28]

17.28 In her view, a last resort compensation scheme should exist to provide redress for consumers suffering loss as a result of inappropriate or negligent financial advice.[29] Ms Lowe informed the committee that such a scheme has 'the capacity to provide a real remedy to people whose lives have been blown apart'.[30]

17.29 The difficulty then is to find the funding to ensure proper compensation. A number of witnesses before the SOFA inquiry referred to this problem. AMP observed:

> The challenge we have, as a large corporate that naturally is very well capitalised and essentially self-insures, is to ask ourselves if it is appropriate that the shareholders and the customers of AMP end up paying for the incompetence of others in the industry. While there is a good argument for that broadly being for the better good of the industry, we also want to ensure that it did not create those moral hazards and so we would be a very willing participant in further consideration of this scheme.[31]

17.30 In effect, according to AMP, such a scheme would never apply to its customers.[32] AMP suggested that it would be timely to revisit the findings of Mr St. John's report on a statutory compensation scheme.[33]

17.31 Mr Andrew Hagger, NAB, similarly recognised that some people, who have dealt with a small firm, go all the way through a system to FOS, receive a judgement

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28 Ms Catriona Lowe, *Submission 200*, paragraph 5.

29 Ms Catriona Lowe, *Submission 200*, paragraph 6.

30 Ms Catriona Lowe, *Submission 200*, paragraph 7. See also, Ms Lowe's observations in paragraph 11.33. For example she stated, while 'industry based EDR theoretically provides this redress for poor adviser conduct, in reality this redress is stymied by the limitations of adviser solvency and PI insurance.

31 Mr Craig Meller, *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 10 August 2015, pp. 1–2.

32 Mr Craig Meller, *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 10 August 2015, pp. 1–2.

33 Mr Craig Meller, *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 10 August 2015, p. 2.

in their favour, which is then not paid. Whereas, in his words, if NAB do the wrong thing, customers can be compensated.[34]

17.32 Mr Nicholas Moore, Macquarie Bank, also referred to people found to be victims who, despite FOS determinations, have not received compensation. He agreed that such people deserve justice but it has not been delivered to them. Mr Moore understood the importance of the industry having professional standing, noting:

> A normal industry professional body does have some sort of compensation scheme; we see it in the law profession with solicitors and with other professional bodies. We would see that, with this part of the evolution of the whole financial planning industry, it would not be an unexpected outcome in terms of ending up here.[35]

17.33 According to Mr Moore, moral hazard is an important concern to bear in mind, but that Macquarie thought that a compensation scheme was an issue that certainly needed examining. He referred to other industry bodies where similar sorts of schemes were in place, so, in his view, there certainly were 'precedents for it out there'.[36]

17.34 Mr Graham Hodges, ANZ, agreed that there was a gap in respect of a scheme of last resort or better arrangements around public indemnity insurance to make sure people do not fall through the cracks. In his view:

> …the problem is that you have myriad players, many of whom do not have much financial means or much protection in terms of insurance. If there is a systemic issue within that planner group then there is a likelihood that that planner group will not have sufficient financial muscle to right the wrong.[37]

17.35 Referring specifically to investors in the failed Timbercorp schemes, he explained further:

> …the issue for many of these people is that the limited amount of insurance or personal indemnity insurance these practices had was gone very quickly and there were many, many clients affected. So there is nowhere for these people to go other than, as a number did on several occasions, to work through a class action. In the Timbercorp case they lost comprehensively on two occasions, at further cost and with further delay and at further cost to

34 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 21 April 2015, p. 45.

35 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 21 April 2015, p. 21.

36 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 21 April 2015, p. 21.

37 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 21 April 2015, p. 24.

> the individuals, because they were advised by the lawyers not to pay their loans.[38]

17.36 ANZ's preferred option would be for organisations that have sufficient financial strength and can pay out as required for mistakes to be allowed to effectively self-insure because they have the capital behind them. Organisations that do not have sufficient financial strength, however, 'would be required to take out some sort of insurance'.[39] He also recognised the issues of moral hazard but thought they could be minimised and would probably be a lesser issue if planners' insurance costs rose as a result of their mistakes. Mr Hodges elaborated:

> When you meet with the people who have gone through the extreme hardship that some have, where there is no-one to go to, you can see why it is worthwhile putting in place a scheme, even if there is some reduced risk of moral hazard, I believe.[40]

17.37 ASIC supported 'consideration' of the introduction of a limited statutory compensation scheme. It noted that it does not have the power to award or compel an AFS licensee to pay compensation where the licensee has caused direct financial loss to retail investors. ASIC suggested that an independent 'statutory compensation scheme would supplement PI insurance and the formal determination of claims by EDR schemes'.[41]

17.38 As a final observation on the need for a compensation scheme of last resort, Ms Lowe noted that the problem encountered by the victims of unsound financial advice was significantly broader than Timbercorp. She referred particularly to evidence submitted to the committee's inquiry into the scrutiny of financial advice.[42]

Committee view

17.39 Clearly, the current system for compensating retail investors who have suffered financial loss as a direct result of inappropriate financial advice is failing the investors. Despite the work of FOS, many people who have received favourable FOS determinations are unable to receive fair compensation because their adviser had inadequate insurance and, in many cases, declared bankruptcy.

17.40 In light of the evidence, the committee recognises that some form of compensation scheme for the victims of bad financial advice warrants much closer

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38 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 21 April 2015, p. 25.

39 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 21 April 2015, p. 25.

40 *Proof Committee Hansard*, Senate Economics References Committee inquiry into the Scrutiny of Financial Advice, 21 April 2015, p. 25.

41 *Submission 34*, paragraph 223.

42 Ms Catriona Lowe, correspondence to committee, January 2016, paragraph 6.

consideration. The committee resolved that, rather than duplicate work and examine this matter as part of its MIS inquiry, it would investigate a compensation scheme of last resort as part of its SOFA inquiry. One of SOFA's terms of reference goes directly to this matter—whether existing mechanisms are appropriate in any compensation process relating to unethical or misleading financial advice and instances where these mechanisms may have failed.

Chapter 18
Conclusion

> As part of a small group of weary victims tied into the Class action we have been disappointed and frustrated at every turn and have been let down by everybody who is supposed to have our best interests at heart.[1]

18.1 Based on the experiences of retail investors who invested in agribusiness MIS, the committee has made a number of recommendations directed at improving the standard of advice provided by financial advisers, product issuers and research houses. In this chapter, the committee recognises the important role that ASIC has in enforcing the powers conferred on it. The committee has also advocated expanding and strengthening ASIC's power which further underlines the regulator's central role. The committee then summarises its findings and recommendations.

ASIC

18.2 ASIC informed the committee that it registers and regulates registered MIS 'at every point from their incorporation through to their winding up' and also ensures that officers comply with their responsibilities. In its view, this 'cradle to the grave' approach 'enhances regulatory oversight'.[2] ASIC also has formal powers to conduct surveillance checks of MIS.[3]

18.3 The committee examined in great depth the performance of ASIC in its 2014 report and consequently will only deal briefly with the effectiveness of ASIC as a regulator of MIS. In its report on the performance of ASIC, the committee noted Professor Dimity Kingsford Smith's reference to ASIC's after-the-loss approach to enforcement, which she described as: 'waiting for complaints, investigating a minute proportion of them, and prosecuting even fewer'.[4] The committee also quoted from a former enforcement adviser at ASIC, who spoke of a regulator that lacked 'a culture of urgency, pro activity and flexibility', with its processes driven by 'a management culture that has a wait and see attitude'. Indeed, Mr Niall Coburn suggested that if there were hundreds of complaints from individuals in a MIS, he doubted whether

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1 Mr Greig Allan, *Supplementary Submission 133.1*.

2 *Submission 34*, paragraph 21.

3 Section 601FF of the Corporations Act.

4 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 4.21. Dimity Kingsford Smith, 'A Harder Nut to Crack?', Responsive Regulation in the Financial Services Sector' forthcoming in symposium issue on responsive regulation in (2011) Univ British Columbia Law Review (Summer 2011). p. 698.

ASIC could pick up on the message or put it together and, if it could, it would still fail to react.[5]

18.4 In 2014, the committee considered two case studies in depth—predatory lending practices and financial advice provided by Commonwealth Financial Planning Limited (CFPL). In both cases, the committee found that ASIC's response to known problems was too slow and disappointingly unenthusiastic. For example, in respect of poor lending practices, the committee concluded that:

> ASIC had available to it persuasive and less formal measures to stop unscrupulous practices. In this regard, the committee believes that ASIC did not take the opportunity to intervene in a far more direct and public way. It did not send a strong message regarding its concerns about irresponsible lending practices to lenders. Nor did ASIC do enough to alert Australian consumers to the risks associated with low doc loans, their vulnerability to irresponsible or even fraudulent activity, and of the need to protect their own interests. Such early and decisive publicity may have educated the community about ASIC's limited ability to protect their interests and minimised the damage.[6]

18.5 The committee's observation applies with equal force to the marketing of agribusiness MIS to retail investors, especially the need for early and decisive publicity to warn potential investors of the risks associated with certain financial products or advice.

18.6 When it came to reports of wrongdoing in CFPL, the committee formed the view in 2014 that:

> Evidence received during this inquiry has underlined ASIC's poor handling of the CFPL whistleblowers and the information they provided. The committee regards the fact that it took ASIC nearly 17 months to take meaningful action in response to the information provided by the CFPL whistleblowers as a significant failure on the part of the corporate regulator. Having said that, the committee notes that ASIC has itself acknowledged its failures in this regard, both in terms of taking too long to move toward an enforceable undertaking…and in terms of its handling of the CFPL whistleblowers and the information they provided.[7]

18.7 This concern about ASIC failing to take decisive steps early to prevent further consumer harm was also evident in the case of the promotion and selling of

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5 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission.*, June 2014, paragraphs 16.34–16.36 and Inquiry into the performance of the Australian Securities and Investments Commission, *Committee Hansard*, 21 February 2014, p. 1.

6 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 5.72.

7 Senate Economics References Committee, *Performance of the Australian Securities and Investments* Commission, June 2014, paragraph 9.47.

agribusiness MIS. The only difference was that ASIC became aware of concerns through much of its own surveillance, but its response was still nonetheless tepid.

Criticism of ASIC

18.8 A number of witnesses were dissatisfied with ASIC's performance when it came to agribusiness MIS. Mr David Cornish of Cornish Consultancy believed that ASIC must take its share of the blame for the losses incurred by the many thousands of investors. He referred to the regulator's lack of policing of corporate governance of the schemes 'even when it became public knowledge of questionable Corporate Governance'.[8]

18.9 One investor was of the view that ASIC's involvement as a regulator appeared to be 'more like that of an observer rather than an active participant in protecting those who are less informed than the advisers who take advantage of them'.[9] Another described ASIC's contribution as 'sitting on the sidelines'—'there seems to be threats they will get involved but in reality they seem to sit and allow things to fall as they may'.[10] Yet another investor stated:

> It is my current view that there is absolutely no consumer protection for financial products. I am a point in case. I took the advice of a fully licensed financial planner with the appropriate insurances. I was sold a product on misinformation that he took huge commissions for. When it all imploded he has walked away, I have not [been] protected or looked after in any way. Indeed, the very agencies charged with that, such as ASIC, the Financial Ombudsman, and the Courts have not only failed me but they seem to be the protector of business.[11]

18.10 In the view of one investor, a client of Mr Holt:

> It seems to us that the overall performance of ASIC has been grossly inadequate. Had a swift and thorough investigation taken place into Peter Holt and his associates, it would have prevented years of needless stress, anxiety, heartache and despair for his victims and protected them from the likelihood of losing their life savings, their homes, their mental health and their self-esteem.[12]

18.11 The committee has made recommendations to strengthen ASIC's powers in order to provide more robust investor protection measures by enhancing and expanding banning powers and conferring the power to intervene in the marketing of products. But, for some time, the committee has been concerned about ASIC's slow and inadequate response to employ the powers it already has. Should the government proceed to implement the FSI and committee's recommendations, the onus rests

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8 *Submission 60*, p. [3].

9 Name withheld, *Submission 68*, p. [2].

10 Name withheld, *Submission 70*, p. [1].

11 Name withheld, *Supplementary Submission 52*, p. [2].

12 *Confidential Submission 37*, p. 1.

squarely on ASIC's shoulders to exercise its powers accordingly. Importantly the government must ensure that ASIC has the resources it needs to carry out its responsibilities effectively.

Enforcement

18.12 In most cases, retail investors only became aware of the flawed financial advice after the MIS collapsed. One particular area of concern relates to ASIC's response to financial advisers who provided inappropriate advice to retail investors. In this regard, the committee has before it numerous examples of investors receiving and acting on advice from individuals who, according to ASIC, did not hold an AFS licence but were authorised representatives of a number of companies including Financial Wisdom, a top 10 seller of Timbercorp financial products. Some were authorised representatives of Timbercorp Securities Limited. They appear to have been instrumental in convincing their clients to invest in an agribusiness MIS and facilitating that investment, including arranging the loan. Despite complaints against them, ASIC has not taken action.[13] The committee has not made the names of these individuals public.

18.13 In a number of cases cited in this report, the adviser who allegedly provided inappropriate recommendations no longer holds, or ever held, an ASF licence. In this regard the committee has named two particular individuals—Mr Peter Holt and Mr Steve Navra. ASIC has banned Mr Holt for three years for, among other things, failing to have a reasonable basis for the advice he gave to retail clients but has taken no action against Mr Navra. Mr Steve Navra was a significant seller of Great Southern products between 2006 and 2009 and, according to a number of submitters, engaged in unethical practices. It should be noted that, as a result of its investigations into the collapse of Timbercorp and Great Southern, ASIC:

> …did require a number of Australian financial services licensees to write to clients where there were indicators of potentially inappropriate advice. The letters to affected clients explained how to make a complaint in connection with the advice provided including information about the licensee's internal dispute resolution (IDR) process and the external dispute resolution (EDR) process.
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> Further, as a result of ASIC's inquiries into these collapses, one licensee provided an undertaking to ASIC that it would immediately cease to provide financial services to retail clients while a number of licensees introduced new training programs for its financial advisers.[14]

18.14 Apart from what appears to be very lenient penalties for the harm caused to clients, there appears to be a real problem taking action against people or businesses that either never held an AFS licence or no longer hold such a licence. Unfortunately, the MIS experience has left many retail investors believing that their financial adviser

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13 ASIC, confidential answer to written question on notice, No. 19. These advisers are not listed on ASIC's Financial Advisers' Register.

14 ASIC, 'Information for Timbercorp Growers', http://asic.gov.au/about-asic/media-centre/key-matters/information-for-timbercorp-growers/ (accessed 24 November 2015).

or accountant, who abused their position of trust to advantage themselves, has not been brought to account and, even worse, continues in some form to practice in the industry.

18.15 It is important that penalties contained in legislation provide both an effective deterrent to misconduct as well as an appropriate punishment, particularly if the misconduct can result in widespread harm. Insufficient penalties, or the failure to apply them, undermine the regulator's ability to do its job. Inadequately low penalties or poor enforcement do not encourage compliance or make regulated entities take threats of enforcement action seriously. In 2014, the committee considered that a compelling case had been made for the penalties currently available for contraventions of the legislation ASIC administers to be reviewed to ensure they are set at appropriate levels. The committee reinforces this recommendation. But, ASIC must also ensure that it uses its powers to effect in order to send a potent message to all those in the financial services industry that it is serious about exposing misconduct and bringing the full weight of the law to bear on wrong-doers.

Recommendation 24

18.16 The committee recommends that ASIC review the complaints made against advisers and accountants, licensed or unlicensed, who engaged in alleged unscrupulous practices when recommending that their clients invest in agribusiness MIS. The review would identify any weaknesses in the current legislation that impeded ASIC from taking effective action against those who engaged in such unsound practices. This review would also examine the adequacy of the penalties available to ASIC to impose on such wrong doers. In particular, ASIC should consider the adequacy of penalties that apply to those who were unlicensed or have since become unlicensed. Banning in such cases is redundant.

18.17 The committee also recommends that as part of this review, ASIC consider the practice of advisers using bankruptcy as a means to avoid recompensing clients who have suffered financial loss as a result of their poor financial advice and any possible remedies.

18.18 Finally, the committee recommends that ASIC provide its findings to the committee.

18.19 The following section provides a summary of the committee's findings located throughout this report and their accompanying recommendations.

Committee findings and recommendations

18.20 Overall, the committee has made recommendations directed not only at improving the advice provided by financial advisers but, importantly the product issuers and the research houses or experts that rate the schemes. The committee acknowledges that the investor must take responsibility for their own decisions and has made recommendations to strengthen disclosure obligations. Armed with accurate and reliable information, which is presented in a clear and comprehensible way that clearly spells out the risks associated with the scheme, should enable the investor to make informed decisions.

18.21 Furthermore, there was irresponsible lending on a systemic basis by representatives of the RE and, at best, a laxity on the part of the major lenders to scrutinise the loan arrangements that many borrowers were entering. The revelations of the lending practices around the MIS should be understood in the broader context of predatory lending practices that emerged before 2008, which clearly demonstrated that any form of industry self-regulation would be inadequate. The committee believes that the government should give priority to reforming this area of investment credit.

18.22 The committee also recognised that the legislative framework around the winding-up of an MIS needs reform and has, accordingly, made a recommendation. Finally, when considering the harm caused by the failure of such high-profile agribusiness MIS, the committee formed the view that a review be undertaken before any decisions about the taxation incentives offered to investors are made. The committee's main findings and recommendations are listed below.

Removing misconception about government endorsement of schemes

It would appear that some product issuers and financial advisers allowed, or even encouraged, investors to assume that an Australian Taxation Office (ATO) product ruling meant that the government was vouching for the commercial viability of the scheme. There was a similar misunderstanding that ASIC was giving its support to the schemes. Thus, growers mistakenly formed the view that the products had ATO and ASIC approval and considered the various schemes safe and suitable for retail investors.

Recommendation 1 **paragraphs 4.49–4.50**

The committee recommends that the ATO undertake a comprehensive review of its product rulings to obtain a better understanding of the reasons some investors assume that an ATO product ruling is an endorsement of the commercial viability of the product. The results of this review would then be used to improve the way in which the ATO informs investors of the status of a product ruling.

The committee recommends that the ATO and ASIC strengthen their efforts to ensure that retail investors are not left with the impression that they sanction schemes, including the use of disclaimers prominently displayed in disclosure documents including PDS.

Future of Financial Advice reforms

The committee recognises that the Future of Financial Advice (FOFA) reforms may well have remedied one of the most pernicious incentives underpinning poor financial advice—commissions. The evidence clearly highlights, however, the importance of ensuring that there are no loop-holes in this legislation that would allow any form of incentive payments to creep back into the financial advice industry.

Recommendation 2 **paragraph 7.51**

The committee recommends that ASIC be vigilant in monitoring the operation of the FOFA legislation and to advise government on potential or actual weaknesses that would allow any form of incentive payments to creep back into the financial advice sector.

Accountants/tax agents providing financial advice

In light of the evidence and the concerns expressed about possible conflicts of interest and blurring of responsibilities in situations where a tax agent provides financial advice, the committee is convinced that this area of financial advice should be reviewed, particularly advice on borrowing. Clearly, there are important lessons to be learnt from the experiences of retail investors who acted on advice from their accountants or tax agent and invested in MIS.

Recommendation 3 **paragraph 7.67**

While noting the 1 July 2016 expiry of the 'accountants' exemption' under Regulation 7.1.29A of the Corporations Regulations 2001, the committee recommends that the Treasury look closely at the obligations on accountants or tax agents providing advice on investment in agribusiness MIS (or similar schemes). The intention would be to identify any gaps in the current regulatory regime (or the need to tighten-up or clarify regulations) to ensure retail investors are covered by the protections that exist under FOFA and that the level of regulatory oversight of tax agents or accountants providing advice on agribusiness MIS (or similar schemes) does not fall short of that applying to licensed financial advisers.

Financial literacy

ASIC provided the committee with examples of its efforts to lift the standard of financial literacy in Australia. The committee has made recommendations that would place obligations on product issuers and research houses to act responsibly in the promotion and marketing of MIS. Much more, however, is required to provide investors with the information needed to protect their own interests. The committee recognises that improved financial literacy will go some way to help consumers make informed decisions.

Recommendation 4 **paragraphs 8.8–8.9**

The committee agrees with the view that financial literacy has 'got to get aggressive' and recommends that the Australian Government explore ways to lift standards. In particular, the government should consider the work of the

Financial Literacy Board in this most important area of financial literacy to ensure it has adequate resources.

Drawing on the lessons to be learnt from the evidence on the need to improve financial literacy in Australia, the committee also recommends that the Australian Government in consultation with the states and territories review school curricula to ensure that courses on financial literacy are considered being made mandatory and designed to enable school leavers to manage their financial affairs wisely. The course content would include, among other things, understanding investment risk; appreciating concepts such as compound interest as friend and foe; having an awareness of what constitutes informed decision-making; being able to identify and resist hard sell techniques; and how to access information for consumers such as that found on ASIC's website. Financial literacy should be a standing item on the Council of Australian Governments' (COAG) agenda.

Culture in the financial services industry

The committee notes that a code of ethics was one of the government's proposed legislative amendments to raise financial advisers' standards. In light of the evidence demonstrating that integrity issues were at the heart of some of the poor financial advice given to MIS investors, the committee highlights the importance of establishing such a code of ethics and suggests that this measure warrants close and determined attention.

Recommendation 5 paragraph 8.28

The committee recommends that the government give high priority to developing and implementing a code of ethics to which all financial advice providers must subscribe.

Banned or unscrupulous advisers

In its response to the FSI report, the government indicated its intention to develop legislation allowing ASIC to ban individuals in management roles within financial firms from operating in the industry. The committee welcomes this move but, to underline the importance of removing opportunities for a banned financial adviser to resurface in other roles in the industry, the committee considers that the term 'management' may be too narrow. Thus, in light of the findings of this committee in two previous reports and of the FSI, the committee reinforces two recommendations it made in June 2014.

Recommendation 6 paragraph 8.45

The committee recommends that the government consider the banning provisions in the licence regimes with a view to ensuring that a banned person cannot be a director, manager or hold a position of influence in a company providing a financial service or credit business.

Recommendation 7 paragraph 8.46

The committee recommends that the government consider legislative amendments that would give ASIC the power to immediately suspend a financial

adviser or planner, subject to the principles of natural justice, where ASIC suspects that the adviser or planner has engaged in egregious misconduct causing widespread harm to clients.

Disclosure documents

The inadequacy and complexity of MIS disclosure documents and accompanying advice has been of long-standing concern. Agribusiness MIS are complex products and difficult to understand. Disclosure documents—prospectuses, PDSs and Statements of Advice (SOAs)—proved inadequate in alerting consumers to the risks of investing in agribusiness MIS. The inadequacies in the disclosure together with poor financial advice and slick promotional strategies created an environment unsuited to informed and considered decision-making.

The evidence underscores, as noted previously, the importance of PDSs doing what they are intended to do—help consumers compare and make informed choices about financial products.

Recommendation 8 **paragraphs 9.77–9.80**

The committee recommends that, based on the agribusiness MIS experience, the Australian Government consult with industry on ways to improve the presentation of a product's risks in its respective PDS. The intention would be to strengthen the requirements governing the contents and presentation of information, particularly on risks associated with the product. This measure should not result in adding to the material in these documents. Indeed, it should work to further streamline the contents but at the same time focus on information that an investor requires to make an informed decision with particular attention given to risk.

With this objective in mind, the committee also recommends that the government consider expanding ASIC's powers to require additional content for PDSs for agribusiness MIS.

The committee recommends further that ASIC carefully examine the risk measures used in Europe and Canada mentioned by the FSI and prepare advice for government on the merits of introducing similar measures in Australia.

In conjunction with the above recommendation, the committee recommends that the government consider the risk measures used in Europe and Canada mentioned by the FSI to determine whether they provide a model that could be used for Australian PDSs.

General advice provided during promotional events

The committee welcomes the government's undertaking to replace the term 'general advice' with a term that clarifies the distinction between product sales and financial advice. It is not convinced, however, that renaming the term, in and of itself, provides adequate consumer protection particularly in circumstances where the product producer uses seminars and dinners to promote the product. The committee heard numerous accounts of growers, who attended seminars or promotional dinners, being encouraged to sign up to invest in agribusiness MIS. It has highlighted the role that investment seminars had in influencing investors and is particularly concerned about the way in which scheme promoters used high pressure or hard sell techniques during so called public 'information' or 'educational' sessions. This advice would be classified as general advice.

In the highly charged environment around information sessions, there should be clear obligations on the promoters engaging in this type of marketing to ensure that potential investors are made fully aware of the risks carried by the product they are promoting. Investors must have access to full and accurate information about the product and be discouraged from signing up before receiving independent financial advice—that is receiving personal advice with all the attendant regulatory safeguards. Worryingly, however, the committee notes occasions where the financial adviser was very much part of the promotional team.

Recommendation 9 paragraph 10.21

The committee recommends that the government consider not only renaming general advice but strengthening the consumer protection safeguards around investment or product sales information presented during promotional events.

Recommendation 10 paragraph 10.22

The committee recommends that ASIC strengthen the language used in its regulatory guides dealing with general advice. This would include changing 'should' to 'must' in the following example:

> **You <u>must</u> take reasonable steps to ensure that the client understands that you have not taken into account their objectives, financial situation or needs in giving the general advice.**

Recommendation 11 paragraph 10.25

In light of the concerns about the lack of understanding of the role that referral networks had in selling agribusiness MIS without appropriate consumer protections, the committee recommends that the government's consideration of 'general advice' also include the role of referral networks and determine whether stronger regulations in this area are required.

Research houses experts' reports

The committee acknowledges that there are numerous participants who offer products or services within the financial advice value chain that influence, directly or indirectly, consumers' decisions on financial matters. It particularly notes that research houses and subject matter experts produce reports containing important information for financial advisers and investors in agribusiness MIS. Generally, such information is attached to, or included in, disclosure documents including PDSs. Under the user pays model, however, the experts' opinions may be biased by the remuneration offered by the product issuer and the promise of further business. In the committee's view, research houses and experts providing opinions should be held to high standards of honesty and integrity. In this regard, the committee notes the relevant International Organization of Securities Commission's (IOSCO) statement of principles governing integrity and ethical behaviour and is of the view that they should apply and have force in Australia.

The committee is concerned that the message about compliance and adherence to high ethical standards is not reaching all participants in the industry.

Recommendation 12 paragraph 10.52

In respect of research houses and subject matter experts providing information or reports to the market on financial products such as agribusiness MIS, the committee recommends that the government implement measures to ensure that IOSCO's statement of principles governing integrity and ethical behaviour apply and have force. In particular, the committee recommends that the government consider imposing stronger legal obligations on analysts, and/or firms that employ analysts to rate their product, to act honestly and fairly when preparing and issuing reports and applying ratings to a financial product.

Role of the banks

The committee is firmly of the view that the banks that financed investor loans through the financing arm of both Timbercorp and Great Southern cannot outsource their responsibilities for allowing borrowers to enter into unsafe loans. Even though the banks were not directly involved in arranging the loans and can legally distance themselves from the loan arrangements, they absolutely owed a duty of care to borrowers. As such, the committee contends that the banks, or liquidators with the banks' support, should, as a gesture of good-will, extend to those borrowers special consideration in resolving their outstanding debts.

The committee is disappointed that an apparent adversarial mind-set is undermining the work of the independent hardship advocate (IHA), which was appointed by the liquidator of Timbercorp, KordaMentha. Despite this initiative, the Holt Norman Ashman Baker Action Group (HNAB–AG), a collection of investors who received advice from Mr Peter Holt or his associates, continues to raise complaints against the IHA. The engagement of the advocate had the potential to defuse the confrontational and ultimately damaging relationship that had developed between the liquidator and this group of borrowers. The committee takes the view, however, that despite falling far short of HNAB–AG's expectations, the work of the IHA still offers a more productive way to resolve long-standing disputes over unpaid loans.

Recommendation 13 paragraphs 11.63–11.64

The committee recommends that KordaMentha continue, through its hardship program, to resolve expeditiously outstanding matters relating to borrowers who are yet to reach agreement on repaying their outstanding loans from Timbercorp Finance.

The committee recommends that spokespeople for HNAB–Action Group consult with KordaMentha and the independent hardship advocate on implementing measures that would help to restore confidence, faith and good-will in the hardship program.

Recommendation 14 **paragraph 11.78**

The committee recommends that Bendigo and Adelaide Bank support the appointment of an independent hardship advocate to assist borrowers resolve their loan matters relating to Great Southern.

Regulation around investment lending

Investment lending has been instrumental in causing significant financial loss to retail investors who borrowed to invest in agribusiness MIS. In the committee's view, the responsible lending obligations imposed on brokers and lenders through the new credit laws should apply equally to the promoters, advisers and lenders involved in providing funds for investment purposes. The committee has no desire to stifle funding for investment, but to put an end to situations where retail investors are unwittingly entering into unsuitable loan arrangements. The committee is particularly concerned about consumers being encouraged to take out 'full recourse' loans, which means that, in the case of default, the lender can target assets not used as loan collateral. Evidence presented to the committee shows that, in many cases, investors did not realise that if their investment failed to generate the anticipated returns or failed completely, they would need to meet repayments from other sources and could be at risk of losing their home.

The committee is also extremely troubled by the numerous accounts of growers signing over a power of attorney to their adviser to arrange and refinance loans. Clearly, there was a serious breakdown in communication with growers unaware not only of the risky investment venture but of the high risk loan agreement they entered.

These glaring gaps identified in the regulatory framework around credit laws mean that retail investors borrowing to invest are not covered by the responsible lending obligations. The committee formed the view that this situation needs to be remedied. The consultation process, which commenced with the release of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, would provide an ideal starting point for reform and should include recourse loans for agribusiness MIS. The committee understands a referral of legislative power from the states and territories would be required.

Recommendation 15 **paragraph 11.92**

The committee recommends that the Australian Government initiate discussions with the states and territories on taking measures that would lead to the introduction of national legislation that would bring credit provided predominantly for investment purposes, including recourse loans for agribusiness MIS, under the current responsible lending obligations. The provisions governing this new legislation would have two primary objectives in respect of retail investors:

- **oblige the credit provider (including finance companies, brokers and credit assistance providers) to exercise care, due diligence and prudence in providing or arranging credit for investment purposes; and**

- **ensure that the investor is fully aware of the loan arrangements and understands the consequences should the investment underperform or fail.**

Recommendation 16 **paragraph 11.93**

The committee recommends that the Australian Government consider ways to ensure that borrowers are aware that they are taking out a recourse loan to finance their agribusiness MIS and also to examine the merits of imposing a maximum loan-to-valuation limit on retail investors borrowing to invest in agribusiness MIS.

Recommendation 17 **paragraph 11.94**

The committee recommends that the Banking Code of Conduct include an undertaking that the banks adhere to responsible lending practices when providing finance to a retail investor to invest. This responsibility would apply when the lender is providing finance either directly or through another entity such as a financing arm of a Responsible Entity.

Legal advice causing harm

Some investors took legal advice to cease repayments on their MIS loans and are now faced with a loan substantially greater than at the time their schemes collapsed. The committee is concerned that vulnerable people who joined class actions expecting, in effect, to have their loans nullified are now in a financial position far worse than when the class actions started.

The committee is firmly of the view that the legal profession has the responsibility to inform itself of the circumstances around the advice provided to retail investors in collapsed agribusiness MIS to cease repayments on their outstanding debts. The profession needs to act to ensure that it maintains high ethical standards and its members adhere to best interest obligations towards their clients.

Recommendation 18 **paragraphs 12.15–12.16**

The committee recommends that the Victorian Legal Services Commissioner and Legal Services Board thoroughly review the conduct of the lawyers who provided advice to retail investors in collapsed agribusiness MIS to cease repayments on outstanding debts and the circumstances around this advice.

The intention would be to determine whether the profession needs to take measures to ensure it maintains high ethical standards and that its members adhere to best interest obligations towards their clients. The investigation would include making recommendations or determinations on:

- **remedies available to investors belonging to the class actions who have suffered considerable financial loss as a result of following advice to cease repayments on their outstanding loans;**
- **whether disciplinary action should be taken against the lawyers who provided the advice to stop repayments;**
- **whether the matter warrants any form of compensation; and**

- **whether the matter should be referred to any appropriate disciplinary body.**

Penalties

There can be no doubt that much stronger measures are needed to protect retail investors from the promotion and marketing of high risk products. A number of inquiries, including the committee's 2014 inquiry into the performance of ASIC and the FSI, have mounted a compelling argument for such action. Agribusiness MIS are a clear example where, based on the evidence before the committee, disclosure was inadequate; information was confusing rather than instructive for retail investors; and oral advice either misinterpreted the disclosure documents, downplayed risks, or selectively presented positive messages. Clearly, improved regulation could have prevented many unwary investors from entering into unsafe financial arrangements.

The committee is of the view that Australia's financial services regulatory regime, with its focus on disclosure, has not served Australian investors well and has not provided a reasonable level of consumer protection. While improved disclosure and education are necessary, they must be accompanied by other measures. Attention must be given to product issuers and their obligation to act in the best interests of investors.

The committee welcomes the government's endorsement of the FSI's recommendation to confer on ASIC a product intervention power. The committee understands that penalties commensurate with the offence are needed to send a strong message to product issuers to act responsibly when marketing products to retail investors. Indeed, in light of the FSI and ASIC's observation regarding the importance of having higher penalties, the committee formed the view that the government should consider increased penalties for serious breaches.

Recommendation 19 paragraph 14.47

To augment ASIC's product intervention power, the committee recommends that the government review the penalties for breaches of advisers and Australian Financial Services Licensees' obligations and, under the proposed legislation governing product issuers, ensure that the penalties align with the seriousness of the breach and serve as an effective deterrent.

Liquidation of agribusiness MIS

Evidence before this committee has highlighted the complicated task of untangling the interests of the various parties affected when an MIS gets into financial difficulties and ultimately fails. In this regard, it should be noted that in November 2010, the government commissioned CAMAC to undertake a review of the current statutory framework for all MIS. The subsequent report was comprehensive and produced a range of well-considered and practical proposals for reform under the current legal framework and, in addition, set out an alternative legal framework for the regulation of schemes.

Recommendation 20 paragraph 15.51

The committee recommends that the government use CAMAC's report on managed investment schemes as the platform for further discussion and

consultation with the industry with a view to introducing legislative reforms that would remedy the identified shortcomings in managing an MIS in financial difficulties and the winding-up of collapsed schemes.

Taxation incentives for agribusiness MIS

In 2005, the government undertook a review of the taxation policy of plantation forestry and, in 2008, conducted a review into non forestry MIS.[15] Since then, there have been major developments in this area that have exposed flaws either in taxation policy and/or its implementation. Now, with the benefit of hindsight, the committee is convinced that, based on the MIS collapses, it is time to examine the tax incentives and any unintended consequences that flowed from them. In particular, the review should look at the extent to which the tax concessions created distortions.

In this respect, the committee notes, however, the pleas from some quarters of the industry not to 'throw the baby out with the bathwater'.

Recommendation 21 **paragraph 16.40**

The committee notes that neither the ATO nor Treasury have undertaken a comprehensive review of the tax incentives for MIS and whether they had unintended consequences, such as diverting funds away from more productive enterprises; inflating up front expenses; or encouraging poorly-researched management decisions (planting in unsuitable locations). The committee recommends that Treasury commission a review to better inform the policy around providing tax concessions for agribusiness MIS.

Recommendation 22 **paragraph 16.41**

The committee recommends further that the proposed review consider the approach to the incentives offered to investors in agribusiness ventures by other countries such as the United Kingdom to inform the review's findings and recommendations.

Recommendation 23 **paragraphs 16.42–16.43**

In addition to the above recommendation, the committee recommends that the government request the Productivity Commission to inquire into and report on the use of taxation incentives in agribusiness MIS. As part of its inquiry, the Productivity Commission should identify the unintended adverse consequences, if any, that flowed from allowing tax deductions for agribusiness MIS. For example:

- **the potential for mis-selling financial products on the tax concessions;**

15 In the 2005–06 Budget, the government announced that it would conduct a review of the application of taxation law to plantation forestry in the context of the government's broader plantation and natural resource management policies. Treasury, *Review of Taxation Treatment of Plantation Forestry*, 22 June 2005, http://archive.treasury.gov.au/contentitem.asp?ContentID=997&NavID= (accessed 22 September 2015).

- **the incentive for retail investors to borrow, sometimes unwisely, to fund their investment;**
- **whether the taxation concessions:**
  - **became an end in themselves rather than the business model;**
  - **showed up as subsidies to higher cost structures, operations and/or returns to the operators of the schemes; and**
  - **distorted land values and diverted high value farmland into passive monoculture such as Blue Gums.**

The main purpose of the inquiry would be to draw not only on the experiences of the failed MIS but also the successful schemes to determine whether there is merit in reforming the system of tax incentives and, if so, what those reforms should be.

Enforcement

It is important that penalties contained in legislation provide both an effective deterrent to misconduct as well as an adequate punishment, particularly if the misconduct can result in widespread harm. Insufficient penalties, or the failure to apply them, undermine the regulator's ability to do its job. Inadequately low penalties or poor enforcement do not encourage compliance and they do not make regulated entities take threats of enforcement action seriously. In 2014, the committee considered that a compelling case had been made for the penalties currently available for contraventions of the legislation ASIC administers to be reviewed to ensure they were set at appropriate levels. The committee has reinforced this recommendation. But, ASIC must also ensure that it uses its powers to effect in order to send a potent message to all those in the financial services industry that it is serious about exposing misconduct and bringing the full weight of the law to bear on wrong doers.

Recommendation 24 **paragraph 18.16–18.18**

The committee recommends that ASIC review the complaints made against advisers and accountants, licensed or unlicensed, who engaged in alleged unscrupulous practices when recommending that their clients invest in agribusiness MIS. The review would identify any weaknesses in the current legislation that impeded ASIC from taking effective action against those who engaged in such unsound practices. This review would also examine the adequacy of the penalties available to ASIC to impose on such wrong doers. In particular, ASIC should consider the adequacy of penalties that apply to those who were unlicensed or have since become unlicensed. Banning in such cases is redundant.

The committee also recommends that as part of this review, ASIC consider the practice of advisers using bankruptcy as a means to avoid recompensing clients who have suffered financial loss as a result of their poor financial advice and any possible remedies.

The committee recommends that ASIC provide its findings to the committee.

In this regard, it should be noted that the committee is currently inquiring into the inconsistencies and inadequacies of current criminal, civil and administrative penalties for corporate and financial misconduct or white-collar crime.

Senator Chris Ketter

Chair

Senator Nick Xenophon—Additional Comments

Government has been MISsing In Action: Time for a Compensation Scheme for MIS Victims

1.1 I commend the Committee for the non-partisan way it has approached this most serious issue and the outstanding work of the Secretariat.

1.2 What is outlined in the Committee's report can, in my view, best be described as a train wreck in slow motion. Government, regulators and financial institutions either saw the train wreck coming, or should have seen it coming.

1.3 There was a seemingly inevitability that Forestry Managed Investment Schemes were going to end in tears.

1.4 The evidence given to the Committee in Melbourne on the 4th of August 2015 by Mr Sam Paton, the respected principal of Agribusiness Valuations Australia, is very telling:

> **Senator WHISH-WILSON:** I want to go to two very quick questions. Unfortunately, we are running out of time. We have looked at lots of different layers, I suppose, of proportioning the blame on why things went astray and led to this catastrophic policy failure. Do you think the government has any role in providing compensation to victims of MIS failures given the role they played in Vision 2020, the tax deductions, the setting up of MISes and not making changes when people were ringing the bells about the risks?
>
> **Mr Paton:** Philosophically I guess that, as I alluded to in here, I cannot feel much sympathy for someone who is so naive as to think that that was their get out of jail card getting in an MIS. I do feel sorry for the people who had financial planners hand out the back, ANZ securitising their loans to invest, but I think—
>
> **Senator WHISH-WILSON:** The buyer beware caveat.
>
> **Mr Paton:** Yes. Out of all the work your committee has been doing, hopefully one good thing is the focus on the banks. That double standard of saying, 'We'll lend them money even though'—I think the best thing government can do is close this legislation down.
>
> **Senator WHISH-WILSON:** That was my next question. Are they fixable or are they broken?
>
> **Mr Paton:** I do not think so. That supply driven model just does not work. If you want to road test it, just say there was something that looked like it needed a kick-start—a new embryonic industry that just

needed a bit of critical mass. If you could name one—and blue gums was not one—all the other industries like pines and grapes were mature. You would go about it a different way where government would make the developers have some skin in the game. As Senator O'Keefe said to me in the 2007 hook-up, if they had some skin in the game—like if Timbercorp had to stump up half the money and have some involvement and risk sharing—it would be totally different. In a nutshell, I do not think the legislation has any beneficial use.

Senator WHISH-WILSON: I would like to thank you for your evidence in speaking out today. What is really important to me is that there is evidence to this committee that the Liberal government at the time was made aware of these risks by people such as you while they were considering over a very long period of time a policy response. It is good to know that that kind of conversation had occurred.

Senator XENOPHON: I have a very quick question that follows on Senator Whish-Wilson's question about the Ponzi schemes. Without going into what a Ponzi scheme, can I put it to you another way? Is it your view that this was always going to end in tears because it was not a viable way of agricultural production—that it was completely artificial and never sustainable in the longer term?

Mr Paton: Yes, because in my experience you create a supply response where there is underlying demand, and then it evolves on its merits. You keep a sink. The analogy to MIS is that it created, if you like, a supply platform that was always going to fail a bit like in the wool boom. The Australian Wool Corporation ratcheted up the floor price for wool, so it guaranteed growers. It went up from 700c to 870c. The next thing is we had four million bales of wool just like we have a wall of wood we cannot sell. It is a similar analogy. Just leave it to the marketplace to sort out, and keep government out of it.

1.5 Mr Paton was clearly being sardonic in his final comment about the market place being left to sort it out.

1.6 The Government clearly had a role in establishing, by legislation and regulation, an investment scheme that was clearly not sustainable—that was going to eventually fall over like a house of cards.

1.7 As Mr Paton alluded to, Financial Institutions need to be scrutinised for their roles in providing massive lines of credit and loans to these companies, giving ‘mum and dad’ investors a false sense of security that their investment was safe. This was compounded by financial advisors providing poor advice without relevant considerations of the risks.

1.8 Recommendation 17 of the Committee goes in part to the role of the banks in relation to this debacle.

> Recommendation 17
>
> The committee recommends that the Banking Code of Conduct include an undertaking that the banks adhere to responsible lending practices when providing finance to a retail investor to invest. This responsibility would apply when the lender is providing finance either directly or through another entity such as a financing arm of a Responsible Entity.

1.9 The committee received very relevant and significant evidence[1] from Catriona Lowe, Independent hardship advocate for Timber Corp victims. The scheme is clearly welcome, and I have seen first-hand how genuine efforts are being made to resolve difficult matters, for individuals in extraordinarily awful circumstances.

1.10 The Senate reference committee report into The Performance of ASIC in June 2014 did discuss issues of compensation in the context of Commonwealth Financial Planning Ltd. Chapter 17 of the Committee's report discussed the issue of a compensation scheme which is also the subject of the current Scrutiny of Financial Advice inquiry. I expect that Inquiry will provide specific recommendations in due course. However, I flag now that victims of Forestry Managed Investment Schemes need to be included in any such compensation scheme. Existing mechanisms for compensation are inadequate and not appropriate. Government should have a role to adequately deal with victims of a scheme that Government should never have allowed to come into existence in the first place.

Recommendation

That a compensation scheme of last resort for victims of 'Forestry Managed Investment Schemes' be established with a combination of Government funding and a contribution from financial institutions. This should be established in parallel with stricter requirements for insurance for financial planners as part of an ongoing compensation scheme for prospective failures of financial advice.

Senator Nick Xenophon
Independent Senator for South Australia

1 Submission 200.

Australian Greens—Dissenting Report

1.1 The boom and bust in forestry managed investment schemes (MIS) is an almost perfect reflection of the boom and bust in the United States mortgage market that precipitated the global financial crisis (GFC). The core ingredients are all there: political backing at outset; highly leveraged investors enticed by advisors receiving outrageous commissions; irresponsible lending by supposedly venerable banking institutions; ratings agencies providing fanciful evaluations; overstated yields; and inflated asset prices. Along the way alarm bells were sounded and ignored by successive governments, and then the cards came tumbling down. Forestry MIS was Australia's GFC moment.

1.2 Forestry MIS was designed to encourage investment in timber plantations on the back of aggressive government policy to treble the amount of timber plantation in Australia. MIS managed to do with varying degrees of success. It went from being a relatively obscure financial instrument when formally established in 1998, to attracting more than $4 billion worth of investment. Eighty per cent of that investment flowed during a heady five year period from 2004 to 2008. However, it was a Ponzi scheme, and when it collapsed tens of thousands of ordinary Australians lost their money; a network of fast-and-loose financial practices were exposed; and farming communities around the country were left reeling by the rapid takeover and then abandonment of agricultural land.

1.3 Forestry MIS is perhaps the most complicated and intricate of what are now a series of financial scandals that have been uncovered in Australia since the GFC. These misdemeanours have been the subject of number inquiries by this committee, including ongoing inquiries into the conduct of financial advisers and penalties for white collar crime, and the inquiry completed in 2014 into the conduct of ASIC. The ASIC inquiry recommended that the government establish an independent inquiry—possibly a Royal Commission—into the misconduct of advisers and planners within the Commonwealth Bank. Since that time, instances of misconduct have been also been uncovered at the National Australia Bank, ANZ Bank, Macquarie, IOOF and, again, at the Commonwealth Bank. The Greens believe that the grounds for a Royal Commission into the financial services sector are now irrefutable, for the sake of the hundreds of thousands who have been affected, and for the integrity of the financial system. This report into the collapse of forestry MIS should be used as a further opportunity to highlight the need for the highest level of scrutiny to be applied to how Australian's money is being managed.

Recommendation

That the government establish a Royal Commission to examine misconduct within the financial services sector.

Investors and incentives

> Pooling funds from investors is usually more easily achieved with either a company or a commercial trust. The only reason the current MIS structure was chosen was to enable growers to get a tax deduction for their upfront investment.[1]

1.4 The Chair's report seriously underplays the role that taxation incentives provided in fuelling the forestry MIS bubble. The Chair's report's inadequate response to this issue is the principle reason The Greens have submitted a dissenting report.

1.5 While it is true that a number of investors claimed not be have been motivated by taxation incentives, the tax treatment of forestry MIS underpinned confidence in the entire system and was clearly identified by ASIC as the most common reason for investment in MIS as early as 2003, before the bubble.

1.6 Taxation incentives induced demand among investors looking for a vehicle to write-off a lump-sum amount against their income. On the other side of this equation, the upfront payment made by investors provided easy finance for parent companies to establish forestry MIS so long as the responsible entity could provide the illusion that investors were carrying on a business.

1.7 Taxation incentives also gave assurance to banks to lend money—at full recourse—for investment in forestry MIS; and commission structures encouraged the sale of forestry MIS to people ill-equipped to understand the product risk.

1.8 The increase in investor demand for forestry MIS inflated the demand for land for forestry. This contributed to localised increases in the price of land which, in turn, encouraged trees being planted on unsuitable land. With the assistance of drought conditions throughout the period of the forestry MIS bubble, and the inevitable downturn in the value of pulp as a global commodity, this meant that the value of the underlying asset was not able to support investor claims when forestry MIS collapsed: too much was paid for land on which trees didn't grow.

1.9 The business model was fundamentally flawed, and new tax-driven investors were required to keep up the charade; to keep cash flowing. Forestry MIS became a Ponzi scheme.

1.10 The ATO sought to address the perverse tax incentives in 2006 by recognising contributions to forestry MIS as investment in capital. However, the Federal Court found differently, and the government of the day chose not to protect the ATO's view in law. Instead, the then government legislated a specific workaround for forestry MIS that allowed for 70% of investment to be deducted upfront without even having to prove the carrying on of a business.

1.11 Even so, the mere questioning of the validity of MIS tax breaks during this period was enough to act as a catalyst—one of a number—for the collapse of forestry MIS. This puts paid to any suggestion that taxation incentives were not at the heart of

1 John Lawrence, *Submission 194*, p. 2.

the forestry MIS bubble: if tax mattered so little, then why was the threat of any change to the tax deductibility of investment so devastating?

1.12 The recommendations in the Chair's report for Treasury and the Productivity Commission to review tax incentives for MIS would assist in understanding this question better, but they also further avoid a decision on this issue. It is clear that the upfront deductibility facility available through MIS was—and is—a primary incentive for investment in unviable plantations. The Greens believe that the rationale provided by the ATO in 2006 remains valid and that the committee should seek to have this view enshrined in law to prevent another MIS bubble.

Recommendation

That the government should legislate to require investment in forestry MIS to be treated as investment in capital, and for tax deductions to be spread across the life of the asset.

1.13 While the economic story of the collapse of MIS has been laid bare, the political story that sits behind it has not been fully told. Serious questions remains as to why the government didn't act when alarm bells were sounded. Why did cabinet overturn the recommendation of the Minister to change the tax incentives in 2006? What was the role of industry lobbyists in convincing the government to keep forestry MIS and a highly ambitious plantation target? In Tasmania, what was the role of the proposed Tamar Valley pulp mill in providing end-market pressure?

1.14 A litany of reports signalled problems with forestry MIS, including the aforementioned 2003 ASIC report; the 2004 Senate Regional Rural Affairs Committee report into the veracity of the government's plantation targets; the 2009 Parliamentary Joint Committee on Corporations and Financial Services Inquiry into MIS; and the 2012 Corporations and Market Advisory Committee report into MIS.

1.15 It is disappointing that the Chair's report has made little mention of the political failure to prevent a the forestry MIS bubble. That said, it beyond the powers of this committee to compel the witnesses and evidence that is necessary to properly understand the role of vested interests in the boom and bust of forestry MIS. The committee was unable to get company management, accountants, financial planners or rating agencies to appear at public hearings. These people have stories that the mums and dads who lost their money, and the farmers who are left saddled with debt, deserve to hear. This is why a Royal Commission, with all of its coercive powers, is needed into the financial services sector—including forestry MIS—to understand the culpability of government: what did they know, when did they know it, and what did they do about it?

1.16 A Royal Commission is all the more important because, it would appear, that the majority of actors involved in the collapse of forestry MIS did not actually break the law. It is extraordinary that billions of dollars of value and wealth have been wiped out around this country on the back of an asset class that, essentially, the government set up. A lot of people made a lot of money along the way, but it is not clear that there was, technically, any systemic wrongdoing. The laws covering forestry MIS largely relate to whether there was misconduct, or deceptive behaviour, or fraudulent behaviour around the communication of risk; otherwise it was just a really bad investment.

1.17 A Royal Commission will help provide a better answer to victims than 'sorry, it is not illegal for billions of dollars to be wiped out and lots of people to have made money on your behalf'. A Royal Commission will establish who was to blame.

Promoters and producers

1.18 The Chair's report makes a swathe of recommendations covering the regulatory framework for financial advice relating to forestry MIS. These include recommendations relating to the use of ATO product rulings; clarifying the role of accountants; ethical and educational standards for advisors; preventing banned advisors from managing companies; improving product disclosure requirements; and extending consumer credit protections.

1.19 More often than not, these recommendations sit within the broader regulatory framework covering all financial advice. There has been a lot of progress on these and a number of other issues in the eighteen months since the inquiry into forestry MIS was established. This is a result of the work of the other aforementioned inquiries undertaken by this committee, and the government's own Financial Systems Inquiry.

1.20 In this context, the recommendations in the Chair's report, while laudable, often use unnecessarily forgiving language. On no less than eight occasions, the Chair's report suggests that 'government consider' the content of particular recommendations. The lack of conviction in the Chair's report is disappointing given the level of progress made in relation to consumer protections for financial advice, and fails to adequately respond to the gravity of issues raised during this inquiry.

1.21 One the recommendations where the Chair's report fails to show conviction is in relation to the regulation of 'full recourse' loans. As noted earlier, the ability of investors to borrow the full amount of their investment in forestry MIS contributed to the creation of an asset bubble; and, because of the full recourse nature of the loans, dramatically increased the exposure of retail investors to losses when the bubble popped.

Recommendation

That the government legislate such that only limited recourse loans are able to be provided for investment in complicated financial products.

1.22 Of those recommendations that do demonstrate conviction, one sits out as being bizarre. Recommendation 4 details the changes that should be made to the school curricula to improve the financial literacy of school leavers. While this is worthwhile in and of itself, it is completely incongruous to the findings of this inquiry. In the Chair's reports own words 'agribusiness MIS are complex products and difficult to understand'. In evidence provided by ASIC, they stated that:

> …the number of failures and the size of those failures go to the fact that it certainly has not been an investment class that retail investors could have confidence in.[2]

1.23 In other words, forestry MIS was a highly risky financial product that many banks themselves considered unworthy of investment; and it should never have been sold directly to mums and dads. While The Greens have every faith in the ability of the next generation of Australians, changes to the school curriculum will not stop another forestry MIS.

Senator Peter Whish-Wilson
Australian Greens Senator for Tasmania

2 Mr Greg Tanzer, Commissioner, Australian Securities and Investments Commission, *Committee Hansard,* 14 October 2015, p. 19.

Appendix 1

Submissions received

Submission Number	Submitter
1	Mr Brett Lawtie
2	Mr Wayne Grumley
3	Mr Ian Farquhar
4	Name Withheld
5	Mr and Mrs Robert and Lynne Powell
6	Mr and Mrs Ralph and Alison Groth
7	Mr Jim Crowley
8	Confidential
9	Confidential
10	Confidential
11	Confidential
12	Confidential
13	Confidential
14	Confidential
15	Confidential
16	Mr Craig Stranger
17	Mr Tim Stanford
18	Name Withheld
19	Mr Peter Crean
20	Mr Mervin Reed
21	Mr Dinu Ekanayake
22	Australian Taxation Office
23	Australian Restructuring Insolvency & Turnaround Association
24	Tasmanian Farmers & Graziers Association
25	Mr Peter Jack
26	Dr Judith Ajani
27	Name Withheld
28	Mr Mark Battiscombe
29	Mr Anthony Jayantha
30	Name Withheld
31	Name Withheld
32	Name Withheld
33	Name Withheld
34	Confidential
35	Confidential
36	Confidential
37	Confidential
38	Confidential
39	Confidential
40	Confidential
41	Name Withheld
42	Name Withheld
43	Mr and Mrs Ray and Maree Wilde
44	Name Withheld
45	Name Withheld
46	Name Withheld
47	Ms Kathleen Marsh, Holt Norman Ashman Baker Action Group
48	Name Withheld
49	Mr and Mrs Peter and Elaine Wilson

50	Ms Andigone Aguilar
51	Mr Larry Chellin
52	Name Withheld
53	Name Withheld
54	Ms Barbara Gray
55	Mr David Lorimer
56	Name Withheld
57	Confidential
58	Confidential
59	Confidential
60	Mr David Cornish
61	Name Withheld
62	Name Withheld
63	Name Withheld
64	Mr David Abraham
65	Name Withheld
66	Ms Liz Thorby
67	Ms Andigone Aguilar
68	Name Withheld
69	Name Withheld
70	Name Withheld
71	Name Withheld
72	Name Withheld
73	Name Withheld
74	Name Withheld
75	Name Withheld
76	Name Withheld
77	Name Withheld
78	Name Withheld
79	Confidential
80	Confidential
81	Confidential
82	Confidential
83	Confidential
84	Confidential
85	Confidential
86	Confidential
87	Mr Michael McLeod
88	Confidential
89	Name Withheld
90	Confidential
91	Name Withheld
92	Confidential
93	Name Withheld
94	Name Withheld
95	Name Withheld
96	Name Withheld
97	Name Withheld
98	Name Withheld
99	Name Withheld
100	Name Withheld
101	Mr Troy Lott
102	Name Withheld
103	Name Withheld
104	Mr Andrew Reibelt
105	Mr Sean Cadman
106	Name Withheld
107	Mr Stefan Kaiser

108	Mr Shane Richards
109	Mr and Mrs Grant and Karen Lillecrapp
110	Mr Georg Fink
111	Mr Brad Pearce
112	Mr Bill Murrowood
113	Mr Giles Lynes
114	Mr and Mrs Scott and Julie Gannon
115	Confidential
116	Confidential
117	Mr Bernard Kelly
118	Confidential
119	Mr Con Solakidis
120	Name Withheld
121	Name Withheld
122	Bank Reform Now
123	Mr Ken Grech
124	Confidential
125	Confidential
126	Australian Forest Products Association
127	The Institute of Foresters of Australia
128	Confidential
129	Confidential
130	Confidential
131	Name Withheld
132	TFS Corporation Ltd
133	Mr Greig Allan
134	Confidential
135	Department of Agriculture
136	Industry Super Australia
137	Trees Victoria
138	AgriWealth Capital Limited
139	Ms Michelle Johnson
140	Confidential
141	Confidential
142	CPA Australia
143	Chartered Accountants Australia and New Zealand
144	Mr Jeff Chin
145	ANZ
146	Mr Alan Cummine
147	Name Withheld
148	Mr Stephen Koci
149	Agribusiness Valuations Australia
150	Name Withheld
151	Name Withheld
152	Name Withheld
153	Name Withheld
154	Confidential
155	Confidential
156	Confidential
157	Mr Mark Laszczuk
158	Mr Tyson O'Shannassy
159	Mr Shaun Ritchie
160	Confidential
161	Financial Planning Association of Australia
162	Name Withheld
163	Confidential
164	Confidential
165	Confidential
166	Mr Sean Davis

167	Name Withheld
168	Name Withheld
169	Ms Sandra Cordony
170	Mr Peter Tomasetti
171	Name Withheld
172	Name Withheld
173	Mr Miles Blackwell
174	Confidential
175	Mr Peter Bentley
176	Mr Stephen Clissold
177	Name Withheld
178	Mr Philip McGrane
179	Mr Greig Allan
180	Name Withheld
181	Confidential
182	Mr Maurice Thomas
183	Mr Rohan Forrest
184	Name Withheld
185	Name Withheld
186	Confidential
187	Mr Trevor Burdon
188	Mr Mark Hoddinott
189	Mr Ernst Schlechter
190	Mr David Hill
191	Confidential
192	Confidential
193	Confidential
194	Mr John Lawrence
195	Mr Warren Cooper
196	Name Withheld
197	Name Withheld
198	Name Withheld
199	Confidential
200	Ms Catriona Lowe
201	Name Withheld

Appendix 3

CAMAC Managed Investment Schemes

Specific recommendations[1]

Proposed key legislative reforms

CAMAC recommends:

- every RE be obliged to maintain, for each scheme that it operates, a definitive register of the affairs of that scheme
- every RE be obliged to maintain, for each scheme that it operates, a definitive register of the property of that scheme
- the ASIC record of registration identifying the party who is the RE be definitive
- in lieu of the subrogation remedy, counterparties to agreements with the RE as operator of a scheme have rights to claim directly against the scheme property (irrelevant under the SLE Proposal)
- any provision in a scheme constitution, or otherwise, that affords an RE an indemnity for any form of maladministration on its part in relation to that scheme be unenforceable.

Changing the RE of a viable scheme

CAMAC recommends:

- an incumbent RE be obliged to provide reasonable assistance to a prospective RE in certain circumstances
- restrictions be placed on an RE receiving remuneration in advance
- controls be introduced to prevent an RE from becoming entrenched
- changes be implemented to voting requirements for scheme members to replace the RE of an unlisted scheme
- the court be given an extended power to appoint a TRE
- the court be empowered to appoint as a TRE any person considered suitable
- restrictions be placed on the transfer of rights, obligations and liabilities (s

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1 Taken from Corporations and Markets Advisory Committee, *Managed Investment Schemes Report*, July 2012, pp. 14–19, http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2012/$file/mis_report_july2012.pdf (accessed 9 June 2015).

Appendix 2
Public Hearings and Witnesses

Wednesday 12 November 2014,

BEZENCON, Mrs Kerree, Chair, Timbercorp Grower Group Committees for Almonds, Olives, Avocados and Citrus
BROWN, Mr Gerard, Group General Manager, Corporate Affairs, Australia and New Zealand Banking Group Ltd
BRYANT, Mr Michael John, Member, Agriculture Growers Action Group
BYRNE, Mrs Meredith, Private capacity
HALPERN, Ms Naomi Alexandra, Private capacity; and Spokesperson, Holt Norman Ashman Baker Action Group
HENRY, Ms Susan Bennett, Chair, Holt Norman Ashman Baker Action Group
KELLY, Mr Bernard James, Private capacity
MARSH, Mrs Kathleen Ann, Honorary Secretary, Holt Norman Ashman Baker Action Group
McDONALD, Mr John Denis, Private capacity
MORRIS, Mr Jeff, Private capacity
PETERSON, Mr Andrew John, Deputy Chairman, Agriculture Growers Action Group
WHITE, Mr Neil John, Chairman, Agriculture Growers Action Group

Tuesday 4 August 2015, Melbourne

BURDON, Mr Trevor Leslie, Private Capacity
CORNISH, Mr David Robert Compton, Private Capacity
ELLISON, Mr Tom, Private Capacity
HALPERN, Ms Naomi, Holt Norman Ashman Baker Action Group
JAKIMIUK, Mr David, Private Capacity
PATON, Mr Samuel James, Private Capacity

Wednesday 5 August 2015, Launceston

DAVIS, Ms Jan, Private capacity
DOWNIE, Mr Robert, Private capacity
FARQUHAR, Mr Ian, Private capacity
HIRST, Mr Michael George, Private capacity
HIRST, Mr Michael George, Private capacity
HIRST, Mrs Dimity Jane, Private capacity
HOOPER, Mr Richard Brett, Chair, Forestry Advisory Committee, Tasmanian Farmers and Graziers Association
LAWRENCE, Mr John Walter, Private capacity
STEEL, Mr Nicholas, Rural Affairs Manager, Tasmanian Farmers and Graziers Association

Thursday 6 August 2015, Melbourne

BENNELL, Mrs Susie, Director, Sandbach Roberts Pty Ltd for Victims of Great Southern
CAIRNCROSS, Mr Adam Christopher, Private capacity
DILLON, Mrs Rebecca, Private capacity
GALVIN, Mr Michael John, Private capacity
HAIGH, Ms Kate, Corporate Solicitor, Bendigo and Adelaide Bank
HIRST, Mr Michael John, Managing Director, Bendigo and Adelaide Bank
HODGES, Mr Graham, Deputy Chief Executive Officer, ANZ
JOHANSON, Mr Robert Niven, Chairman, Bendigo and Adelaide Bank
JOLLYE, Mr Thomas Guyton, Manager, Sandbach Roberts Pty Ltd
KENDALL, Mr Neil, Chair, Financial Planning Association of Australia
KORDA, Mr Mark, Partner, KordaMentha
McSHANE, Mr Alexander, Private capacity
RANTALL, Mr Mark, CEO, Financial Planning Association of Australia
THOMPSON, Ms Belinda Heather, Partner, Allens Arthur Robinson
TUCKER, Mr Gary Robert, Program Director, Great Southern, Bendigo and Adelaide Bank

Wednesday 14 October 2015, Canberra

BROWN, Ms Diane, Principal Adviser, Financial System and Services Division, The Treasury
CAMPBELL, Mr Russ, Division Head, Small Business Tax Division, The Treasury
DYCE, Mr Tim, Deputy Commissioner, Private Groups and High Wealth Individuals, Australian Taxation Office
EASTMENT, Mr Paul, Senior Manager, Australian Securities and Investments Commission
ELLISON, Mr Christopher, Advisory Director, TFS Corporation Ltd
FRASER, Mr Bede, Manager, Financial System and Services Division, The Treasury
JACOBS, Mr Martin, Assistant Commissioner, Private Groups and High Wealth Individuals, Australian Taxation Office
LOWE, Mr David, Unit Manager, Small Business Entities and Industry Concessions Unit, Small Business Tax Division, The Treasury
MEGSON, Mr Quentin, General Manager of Operations and Corporate Services, TFS Corporation Ltd
SIMPSON, Mr Andrew, Regional Director, Private Groups and High Wealth Individuals, Australian Taxation Office
TANZER, Mr Greg, Commissioner, Australian Securities and Investments Commission

- the powers of the court, upon appointment of a TRE, be expanded
- modifications be made to s 601FS to avoid unintended consequences (irrelevant under the SLE Proposal)
- the duties of a TRE be modified
- the court be empowered to determine the remuneration of a TRE
- the TRE be obliged to provide reasonable assistance to a prospective RE
- the TRE be given the power to place a scheme in VA
- the TRE be obliged to assist an external administrator

Restructuring a financially stressed scheme

CAMAC recommends:

- the legislation define a scheme as being insolvent where the scheme property is insufficient to meet all the claims that can be made against that property as and when those claims become due and payable
- a scheme VA procedure be introduced, with the approach under the SLE Proposal being the preferred option
- the ambit of a scheme moratorium include all rights or claims concerning the RE, scheme members or external parties that might affect the ability of the scheme administrator to restructure the affairs of the scheme
- voting rights on one or more scheme deeds be determined in the first instance by the scheme administrator, with the administrator or affected parties having standing to apply to the court to challenge the administrator's determination
- the court be given a residual power to order that a scheme be discontinued or wound up
- only registered liquidators be eligible to be scheme administrators
- a scheme administrator have similar functions, powers and liabilities to those of a corporate administrator
- the court be empowered to determine the remuneration of the scheme administrator if affected parties cannot agree
- the powers of the court in the VA of a scheme include the equivalent of s 447A
- the scheme administrator or the scheme deed administrator have standing to apply to the court for the appointment of a TRE

Winding up a scheme

CAMAC recommends:

- scheme members be able to approve the winding up of a scheme by 75% of the votes cast, provided the votes in favour of the winding up constitute at least 25% of the total votes of scheme members
- the court be empowered to give directions whenever it thinks it 'appropriate' to do so
- there be provision for a solvent winding up of a scheme become an insolvent winding up only a registered liquidator be permitted to conduct the winding up of an insolvent scheme
- the court be given a power to wind up a scheme on the basis that it is insolvent, and, in consequence, the unsatisfied execution ground for winding up a scheme be repealed
- where an insolvent scheme and its insolvent RE are being wound up without first going through a VA procedure, the liquidator of the RE administer a combined winding up, unless or until the liquidator determines otherwise, with rights of affected parties to apply to the court for a determination on this matter
- the Corporations Act provide general procedures for the winding up of an insolvent scheme, comparable to those for the winding up of an insolvent company
- there be a statutory order of priorities in the winding up of a scheme, providing a first priority for payments to a TRE and thereafter an order of priorities based on that provided for companies in s 556 (which subsequent order of priorities would commence with an equal ranking for payments to a scheme administrator, a scheme deed administrator or a scheme liquidator)
- a former RE or a new RE with claims against scheme property under its indemnity rights be treated as an unsecured, non-priority, creditor of the scheme
- there be voidable transaction provisions applicable in the winding up of an insolvent scheme.

Other matters

CAMAC recommends:

- scheme members be given an extended power to call scheme meetings
- scheme members be given statutory limited liability (which should not be subject to any contrary provision in a scheme constitution)

In response to matters raised in the terms of reference, CAMAC:

- recommends against ASIC having a power to convene a meeting of scheme members
- recommends against an obligation to hold an annual general meeting of scheme members

- recommends against additional controls regarding guarantees given by REs in their personal capacity or as operator of a scheme.