Senate Economics Committee—Inquiry into managed investment schemes (MIS)

ASIC—written questions on notice

Registration of MIS and perception of being approved schemes

1. Investors often drew additional comfort about the security of agribusiness MIS because they thought ASIC had approved the schemes.

- Was ASIC aware of retail investors in agribusiness MIS being under the erroneous impression that an ASIC registered scheme was in fact an endorsement of the MIS?

  ASIC has been aware in the past that there was apparent confusion about its regulatory role in the agribusiness managed investment scheme (MIS) sector with some promoters suggesting that ASIC approved or endorsed offer documents when this is not the case.

  ASIC has recognised that if in particular cases there was a statement that ASIC endorsed or approved the scheme, investors may be misled.

  The change in terminology from "approved deed" to "registered scheme" with the Managed Investment Act 1998 was partly reflecting a desire to minimise the risk of implying endorsement. Companies are also registered with ASIC and retail investors would not generally assume that mere registration of a company implied endorsement of its business.

  *However ASIC has been concerned that some retail investors might have wrongly seen the existence of a formal disclosure document, the Product Disclosure Statement or prospectus, and the operator holding an Australian Financial Services Licence (**AFS licence**) as implying some check by the government regulator that the disclosure was sufficient and the schemes being operated were commercially viable.*

- Between 2000 and 2008, what did ASIC do to alert retail investors to the fact that because an MIS was registered with ASIC did not mean that ASIC endorsed the commercial viability of that scheme?

  ASIC regularly and consistently warned consumers that it did not 'approve' investments, including agricultural MIS schemes. We did this through media releases, consumer warnings, our consumer website FIDO, speeches, media commentary etc.

  By way of example, ASIC Media Release 01-298, 'ASIC gives good oil on olive schemes' contained the following statement:

'ASIC advises potential investors to seek appropriate professional advice on the suitability of such an investment for them, and to also remember that ASIC does not approve the viability of any particular investment'.

ASIC also sought to correct any misconceptions in speeches and information available on ASIC's website. For example, on 20 March 2002, Jillian Segal, Deputy Chair, ASIC, to the Australasian Investor Relations Association, Corporate Disclosure Practices Seminar in Sydney in which she stated the fact that a prospectus is lodged with ASIC does not mean ASIC approves or endorses the nature of the proposal/scheme in any shape or form.

ASIC has been concerned about retail investors misunderstanding our role, particularly in relation to regulated disclosure documents directed to retail investors. ASIC has regularly reviewed whether such disclosure documents contain relevant statutory warnings about ASIC's role. These warnings are mandated by law in s711(7) and s1013J, although these requirements only apply to regulated disclosures that are lodged with ASIC. As a result of the Financial Services Reform Act amendments, which took effect in 2004, agribusiness product disclosure statements have not been lodged.

ASIC has reviewed regulated disclosure documents and promotional material to remove any misleading statements to retail investors suggesting that ASIC in any way approves or endorses the commercial viability of any product or service.

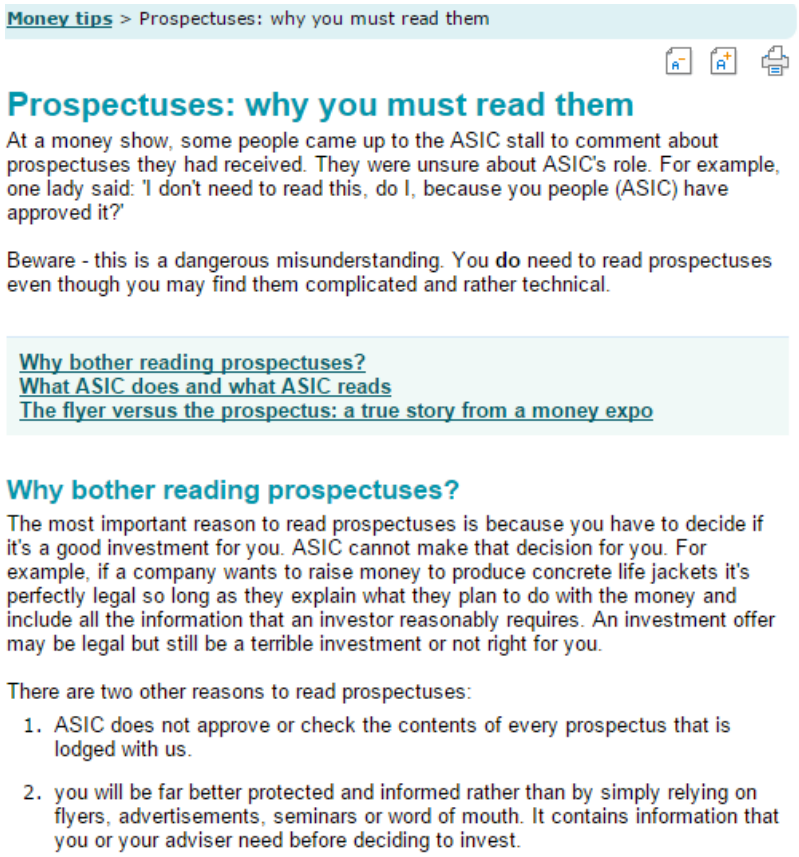
Further, ASIC's consumer and investors website, FIDO contained relevant material for retail investors. FIDO was archived in March 2011 after our MoneySmart website was released. FIDO contained a page about prospectuses which contained the following statements:

Are PDSs lodged with ASIC?

Most PDSs don't have to be lodged with us. A PDS must only be lodged with us if it is for a listed managed investment product, that is one that can be traded on a financial market.

Warning: A PDS or prospectus that has been lodged with us does not necessarily mean it is a good investment.

Another article on the FIDO website, titled 'Prospectuses: why you must read them', also explained that assuming that ASIC has approved a prospectus is a dangerous misunderstanding. It also warned that ASIC does not approve or check the contents of every prospectus that is lodged, as follows:



Money tips > Prospectuses: why you must read them

Prospectuses: why you must read them

At a money show, some people came up to the ASIC stall to comment about prospectuses they had received. They were unsure about ASIC's role. For example, one lady said: 'I don't need to read this, do I, because you people (ASIC) have approved it?'

Beware - this is a dangerous misunderstanding. You **do** need to read prospectuses even though you may find them complicated and rather technical.

Why bother reading prospectuses?
What ASIC does and what ASIC reads
The flyer versus the prospectus: a true story from a money expo

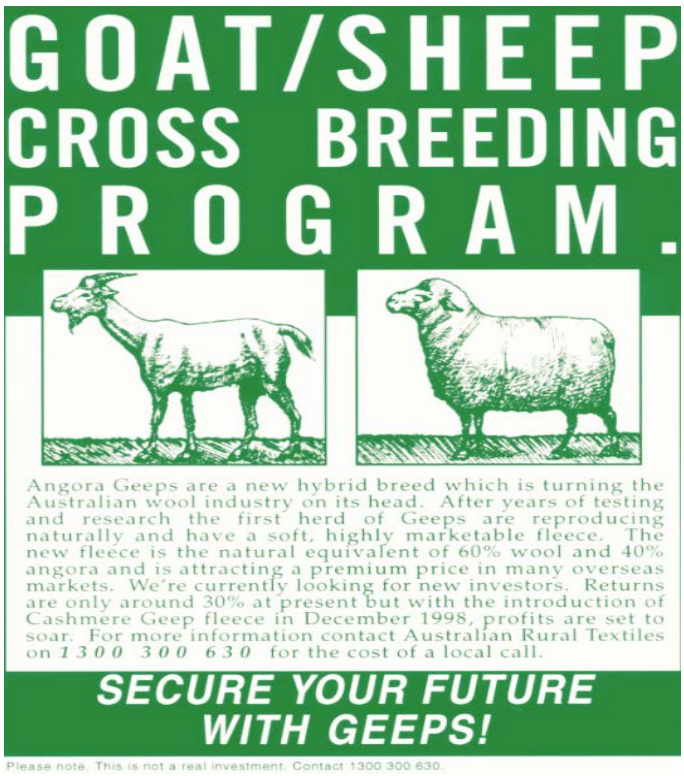
Why bother reading prospectuses?

The most important reason to read prospectuses is because you have to decide if it's a good investment for you. ASIC cannot make that decision for you. For example, if a company wants to raise money to produce concrete life jackets it's perfectly legal so long as they explain what they plan to do with the money and include all the information that an investor reasonably requires. An investment offer may be legal but still be a terrible investment or not right for you.

There are two other reasons to read prospectuses:

1. ASIC does not approve or check the contents of every prospectus that is lodged with us.
2. you will be far better protected and informed rather than by simply relying on flyers, advertisements, seminars or word of mouth. It contains information that you or your adviser need before deciding to invest.

In an effort to ensure the highest level of impact of our consumer messaging, ASIC undertook a range of innovative consumer warnings around this time. For example, ASIC created a number of "fake scams" around April Fools Day in order to emphasise to investors the importance of carefully considering the information presented to them, and several of these had an 'agricultural' theme. One example from the year 2000 was the "Geep", which, while absurd, did generate some enquiries from prospective investors who called the nominated ASIC telephone number with an interest in investing. This also generated very considerable media coverage, which was ultimately the aim so as to highlight messages around careful investing :



Currently our MoneySmart website says on its page about prospectuses, https://www.moneysmart.gov.au/investing/shares/how-to-buy-and-sell-shares/prospectuses#role:

> *"ASIC does not endorse, approve or verify the content of prospectuses but all prospectuses must be lodged with ASIC before any securities are offered to the public".*

The MoneySmart website also includes the following statement at https://www.moneysmart.gov.au/tools-and-resources/check-asic-lists:

> *"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."*

- To ASIC's knowledge, were any product producers or financial advisers sanctioned in any way for misrepresenting ASIC registration of a MIS as an endorsement of the commercial viability of the MIS?

  Where we find misrepresentations about the role of ASIC, including statements that may indicate some ASIC endorsement of a product we have

and will take action to correct these statements and in some cases sanction those parties responsible for those statements. Historically these actions may have involved corrective disclosure.

More recently, ASIC has also issued infringement notices and provided general warnings about claiming to have ASIC endorsement or approval. Some examples include:

- ***ASIC Media Release 15-108, 'ASIC cancels FX company's licence'**, which states that, ' the use of ASIC's logo on the websites could have led clients to wrongly believe the company was in some way endorsed or approved by ASIC.'*
- ***ASIC Media Release 15-011, 'ASIC concerns prompt national warranty company to remove a potentially misleading representation'**, which states that, 'Consumers who deal with licensed businesses are better protected if things go wrong and you will generally have access to free dispute resolution services. However, having a licence does not mean that ASIC endorses the company, the financial product, the advice, or that you cannot incur a loss from the investment or that a financial product will be suitable for a particular consumer's objectives, financial situation or needs.'*
- ***ASIC Media Release 13-351, 'SMSF Property Capital pays penalty for ads promoting ASIC approved financial products'**, which states that, 'ASIC takes the misuse of language such as "ASIC endorsed" or "ASIC approved" very seriously, especially in the area of SMSFs. Creating a false impression of the level of regulatory approval for investments can lead to consumers making poor decisions.'*
- ***ASIC Media Release 11-174, 'Credit licensees warned against misuse of ASIC name and logo'**, which states that, ' ASIC is concerned that use of the ASIC name and logo in conjunction with these identification requirements could cause consumers to believe the business or company is in some way endorsed or approved by ASIC'.*

Geared investment

2. Based on the evidence, investors were allowed to borrow a substantial proportion of the loan—90 to 100 per cent for example.[1] 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.

Also, it would appear that, in many cases, the loan arrangement to invest into an agribusiness MIS was part and parcel of the total investment package so

1 *Submission 102,* p. [1].

that poor, inaccurate, misleading advice and bad adviser behaviour carried over to the loan arrangements.

- What role did ASIC have in monitoring the lending practices by the financing arms of the MIS? Did ASIC take any action against a financial adviser or the financing arm of an RE for poor advice on borrowing to invest in an MIS?

  *ASIC's role was limited because financing of this kind was not regulated under the Corporations Act 2001(**Corporations Act**) and loans were not covered by responsible lending laws. To the extent that ASIC did have jurisdiction at this time, the focus was on mainstream lending products such as mortgages, rather than loans for the purposes of investment.*

  Loans to provide investors with funds for investment in managed investment schemes are credit facilities. This means that a loan is not a financial product for the purpose of the Corporations Act (see s765A(1)(h)), which excludes credit facilities from the definition of financial product), and advice in relation to a loan is not, by itself, a financial service. Lenders and persons who give advice about loans or help clients to obtain loans are not required to hold an AFS licence for this conduct. More broadly though, recommendations or statements of opinion about borrowing funds for investment that are intended to influence the client in making a decision about an interest in a managed investment scheme may form part of financial product advice in relation to the scheme interests.

  *Credit facilities are a kind of financial product for the purposes of the ASIC Act 2001 (**ASIC Act**) (see s12BAA(7)(k)), which specifically includes credit facilities in the definition of financial product). Accordingly, advice and dealing conduct in relation to a loan, including arranging for the client to enter a loan, are financial services for the purposes of the ASIC Act. This means that the consumer protection provisions in Division 2 of Part 2 of the ASIC Act apply where there is unconscionable conduct or misleading or deceptive conduct in relation to financial services relating to a loan.*

  Because of our limited resources, ASIC will only take action against lenders on behalf of individuals or businesses in relation to their private disputes where it is in the public interest to do so. Whether or not ASIC determines to take regulatory action in response to particular matters, individuals retain their rights to pursue their concerns privately and we encourage them to do so.

- Considering that the loan arrangements were often wrapped in with the agribusiness investment, what jurisdiction did/does ASIC have over such lending activities?

ASIC's jurisdiction in relation to these loan arrangements are outlined above.

- To ASIC's knowledge, was any action taken against advisers/accountants for placing retail clients in high risk, highly geared investments?

  ASIC takes regular action against advisers and accountants for placing retail clients in high risk high risk, highly geared investments. This includes agribusiness and other investments. Some examples of action include:

  - *ASIC Media Release 04-105, 'Former ARG Financial Group representatives removed from industry';*
  - *ASIC Media Release 04-111, 'WA financial advisor banned';*
  - *ASIC Media Release 05-371, 'Double Bay accountant appears in court';*
  - *ASIC Media Release 05-08, 'ASIC permanently bans Sydney financial advisers';*
  - *ASIC Media Release 06-374, 'ASIC bans financial service representatives in Victoria and New South Wales';*
  - *ASIC Media Release 07-343, 'ASIC bans two Sydney advisers'*;
  - *ASIC Media Release 08-199, 'ASIC bans former Melbourne adviser and son';*
  - *ASIC Media Release 09-17, 'ASIC bans Brisbane father and son advisers';*
  - *ASIC Media Release 10-228AD, 'Former Perth financial advisor enters into enforceable undertaking with ASIC'*;
  - *ASIC Media Release 12-236MR, 'ASIC bans Victorian financial adviser for failing to comply with financial services laws'; and*
  - *ASIC Media Release 15-057MR, 'Former Gold Coast financial adviser sentenced'.*

  In response to the collapses of Great Southern and Timbercorp, ASIC established a Great Southern/Timbercorp Taskforce in 2009. The Taskforce considered a wide range of issues associated with the collapses ranging from the role of directors, disclosure issues and the appropriateness of advice provided to investors to invest in agribusiness managed investment schemes.

  ASIC collected high level data from the top 20 sellers of Timbercorp and Great Southern which was then analysed against a number of indicators of potentially inappropriate advice. One of the indicators identified was loan to salary ratio and where the investor's percentage of loan to salary ratio was higher than 40% we flagged the adviser for further follow up file audit reviews.

  The other risk indicators formulated to trigger the file audit reviews were:

- *% of total taxable income*
- *% of portfolio invested*
- *Annual Loan repayments*
- *Investor's risk profile*
- *Amount commissions received.*

The high levels of gearing together with other indicators triggered were the basis for file audit selection. The file audit reviews involved the licensees conducting a complete file review of the client file. In most cases, we required the licensees to audit all identified instances of possible inappropriate advice. In some cases the licensee chose to get the services of an independent auditor to review the files. In two cases we required an external auditor to complete the audits due to issues arising from conflicts of interest between the principal of the firm having provided the advice required to be audited.

The compliance action ASIC took involved:

- *11 licensees writing to clients where 2 or more indicators of potentially inappropriate advice were triggered. 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;*
- *4 licensees agreeing to write to clients whose files the licensees had failed to retain;*
- *4 licensees agreeing to new or additional licence conditions relating to the retention of client files;*
- *1 licensee providing an undertaking to ASIC that it would immediately cease to provide financial services to retail clients;*
- *a number of licensees introducing new training program for financial advisers; and*
- *no further action against ten licensees on the basis that the licensee and/or its representative provided appropriate advice.*

ASIC did not take action solely on high risk, high geared investments for agribusiness investments however it was a factor in consideration in conjunction with the other risk indicators formulated.

New credit laws

- To what extent, if at all, will the new credit laws, particularly in respect of responsible lending, address the poor lending practices that were employed by some financial advisers and producers and promoters 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.

- Could you advise the committee on the regulatory regime governing investment lending?

  Preliminary consideration was given to extending the scope of the National Credit Code and Act to cover loans for investment purposes. In 2012, Treasury circulated for comment an Exposure Draft of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012. Schedule 3 to the Exposure Draft of the Bill covered investment lending. The proposed reforms did not progress. In any event, 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. Under the Exposure Draft of the Bill, it was proposed to:

  - *apply the credit licence requirements to persons who engaged in credit activities in relation to investment loans; and*
  - *apply responsible lending obligations only in relation to certain investment loans that have additional risks for consumers, which were identified as:*

    a) loans secured over the family home where the borrower does not appreciate that if the investment does not generate the expected returns, they will need to meet the repayments from other resources and may be at risk of losing their home, depending on their overall financial position; and

    b) loans to finance investments in products being offered illegally, by a person who does not hold an AFS licence (where there is a consequent risk the entire investment proceeds will be lost by the consumer).

Power of Attorney

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

> 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.[2]

A number of submitters raised this matter with the committee. In some cases, they indicated that they were required to sign a Power of Attorney in order to obtain finance to secure their vinelots.[3]

- Was ASIC aware of this practice and if so, what is ASIC's views on the practice?

  ASIC has been aware that growers were gearing their investments into agribusiness schemes. ASIC was not generally aware that growers were required to enter into a Power of Attorney for the purposes of obtaining finance to secure their vinelots.

- Could ASIC explain to the committee the regulatory requirements around an RE or financial adviser's use of power of attorney especially to arrange loans?

  Responsible entities

  Powers of attorney are governed by State legislation. Some states require Registration of the Power of Attorney when it is exercised with respect to land.

  *The legislative provisions that ASIC is responsible for do not contain any specific regulation around the use by a responsible entity (**RE**) of a power of attorney in relation to loans.*

  Regulation 7.1.34 of the Corporations Act Regulations 2001 provides that the enforcement of rights under a credit facility including the enforcement of rights by a person acting under a Power of Attorney does not constitute dealing in a financial product.

  The Corporations Act [see s601FC(1)(a) and (c)] imposes duties on an RE additional to the fiduciary duties an RE has, which require the RE to:

  (a) act honestly; and

  …

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

3 *Submission 91*, p. 2.

(c) act in the best interests of members and if there is a conflict between the members' interests and its own interests give priority to the members' interests; and …

*As an Australian financial services licensee (**AFS licensee**), an RE also has obligations under s912A(1) of the Corporations Act to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly. In addition, in giving advice to retail clients, by s 961B of the Corporations Act the adviser must act in the best interests of their clients.*

*Under ASIC Regulatory Guide 232: Agribusiness managed investment schemes: Improving disclosure for retail investors (**RG 232**) ASIC provided guidance that if the RE or a related party is providing finance, or expects to receive payment for arranging finance, for investors in the agribusiness scheme to fund an investment into the scheme, the RE should clearly and prominently disclose in the PDS:*

(a) the details of the financier;

(b) any amounts paid to the RE or related party in relation to the finance;

(c) that the investor should obtain and read the finance agreement before entering into the finance facility; and

(d) unless the proposed finance facility is non-recourse, that the investor will remain liable to repay the amount lent or made available under the finance agreement should the scheme fail.

Further, the RE should also ensure that, as far as practicable, investors receive a copy of the finance agreement before entering into the finance facility.

As outlined in RG 232, we consider it is important that investors considering funding an investment in an agribusiness scheme through the use of a loan or other finance are provided with adequate disclosure about the terms and conditions of the agreement, where the finance is provided by the RE or a related party, or where the RE may be paid a fee for the arrangement.

In addition we consider that REs should explain any risks associated with the financing arrangement, including the consequences of the loan or amount financed being repayable out of the investor's personal assets.

- In ASIC's assessment, when is granting power of attorney to an RE or financial adviser appropriate and when is it not?

  In our experience in respect of agribusiness schemes, 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.

Notwithstanding the above, we are unable to advise when it is generally appropriate for an RE to use Powers of Attorney.

4. The FPA stated emphatically that a power of attorney for an advisor to sign someone into a loan should not be a practice at all: that it was inappropriate.[4]

- What is ASIC's view?

  *Currently our MoneySmart website says, " **Power of attorney warning** - Don't give your adviser power of attorney. Reputable advisers won't ask you to do this": https://www.moneysmart.gov.au/investing/financial-advice/problems-with-a-financial-adviser*

High pressure selling

5. As early as 2003, ASIC commented on the sales techniques used to sell agribusiness MIS. Importantly, at that time, ASIC came to the conclusion that:

> The findings of this project confirmed anecdotal information provided to ASIC 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.[5]

- What steps were taken after 2003 to curb this type of high pressure selling of agribusiness MIS?

  In answering this question, we note that there are two levels of response to high pressure sales:

  - *legislative reform of the regulatory regime governing such sales and advice through Parliament; and*
  - *ASIC's regulatory work within the existing regulatory regime (at that time).*

4 *Proof Committee Hansard*, 6 August 2015, p. 26.

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

On the first, during this period ASIC operated within a legislative regime where disclosure was the major regulatory tool available to deal with product advice and other claims made to investors about the products. It is important to note that in the regulatory environment at this time, high commissions paid to advisers were legal and there were no controls over complex and high risk products, other than by regulation of the disclosure of those products.

ASIC repeatedly highlighted problems with advice given to investors that was impacted by the conflicts of interest generated by commission-based remuneration (through, for example, adviser shadow shopping projects). As noted above, high commissions payable to advisers were legal at this time, and clearly contributed to the practice of high pressure selling.

*Disclosure was a poor regulatory tool for dealing with the problems arising from commission-based high pressure selling, especially where this was occurring on a systemic basis. Despite this, no legislative steps were taken to curb the impact of commissions and other volume related adviser remuneration, which were the main generators of high pressure selling in agribusiness MIS and other investment products, until the recent Future of Financial Advice (**FOFA**) law reforms.*

On the second issue, please refer to our response to items 1 and 3 for examples of action taken by ASIC in response to inappropriate selling of financial products to retail clients, including warnings to potential investors and actions against advisers.

ASIC's FIDO website also contained information for investors using the services of financial planners, and set out information regarding commissions paid to advisers and alerted investors to matters requiring their consideration, including that most financial planners still made their money out of commissions paid to them by fund managers when investments are made into the fund.

Another article titled, "Agricultural investment schemes" on the FIDO website explained how such schemes work, contained the following warnings:

> *"many of these schemes lose some or all of your money or fail to make a better return than money in a bank account. Crops can fail and plants and animals can lose value as more people invest in them."*
>
> *"Tax-driven schemes usually take a long time before they earn any income (5 to 20 years). If you get all your tax deductions in the first year, any income you earn later is taxable."*
>
> *"Many of the agricultural schemes…arrange finance for you to invest in the scheme….Get legal advice before entering into one of these agreements. The ATO may query the tax deductibility of the loan interest if the investor appears not to be taking any real 'business risk'."*

*ASIC undertook a consultation process in 2010, through which feedback was sought on proposals to improve disclosure to retail investors in the agribusiness managed investment scheme sector (see Consultation Paper 133). The results were published in Report 273: Response to submissions on CP 133 Agribusiness schemes: Improving disclosure for retail investors, and RG 232 was released on 30 January 2012, to improve disclosure practices in this sector. It should be noted, however, that some of the RG 232 requirements were also previously required under Regulatory Guide 170: Prospective financial information (**RG 170**).*

More generally, ASIC published consumer information alerting consumers to key issues via the FIDO website. By way of example, an article titled, "Prospectuses: Why you must read them", which appeared on ASIC's FIDO website, contained the following information:

Danger if the prospectus is hard to get
Let the warning bells ring loudly if sales agents show reluctance to hand over a prospectus. Flyers and seminars will at best just summarise what the prospectus says. If it's hard to get the prospectus, you have fair warning that it may contain vital information.

Stand your ground even if a sales representative says, 'we prefer to get people to come a seminar to explain the investment'. By giving your name and address and to attend a seminar, you are starting to commit yourself psychologically.

Read the prospectuses, it's always worthwhile
Since it's your money, make sure your decisions are well informed. Here's 3 reasons for making the effort:

1. Under the law, directors must stand by what they say in prospectuses. Directors never know which prospectuses ASIC will select for examination, and most of them do their best to disclose the facts.
2. The law expects you or your licensed financial adviser to read what the directors tell you.
3. If you rely on advertising, flyers and statements made at seminars, you are cheating yourself out of vital information which you have a right to know.

General advice/personal advice

6. The committee has mentioned the high pressure tactics used by some advisers. But investors were often primed by managers and product promoters, as well as accountants and financial advisers, at information or marketing events.[6] Many were persuaded to invest by slick and compelling sales tactics: by talk

6 *Submission 4*, p. 1; *Submission 5*, p. 1; *Submission 6*, p. 1; *Submission 25*, p. 1; *Submission 29*, p. 1; *Confidential Submission 39*, p. 2; *Submission 53; Submission 54*, p. [1].

of the 'returns so beautifully outlined and promised in the prospectus'.[7] A number of submitters refer to their advisers as salesmen not financial advisers: that they were not providing advice but merely selling a product not suited to their clients' needs and from which they profited.

- Is it accurate to say that the advice given at such seminars or promotional dinners where people were encouraged to sign up to invest in MIS would be classified as general advice and hence not subject to some of the more robust consumer protection regulations?

  *The definition of 'general advice' in s766B of the Corporations Act 2001 (**Corporations Act**) is broad and captures any recommendation or statement of opinion that is intended to influence a person in making a decision about a financial product or class or products. Where the provider of the advice has considered one or more of the person's objectives, financial situation and needs, the advice is considered 'personal advice'.*

  *There are a range of specific obligations that apply to both general and personal advice, for example, the requirement to provide a Financial Services Guide (ss941A and 941B), the obligation not to engage in misleading or deceptive conduct (s1041H of the Corporations Act or s12DA of the Australian Securities and Investments Commission Act 2001 (**ASIC Act**)) and the obligation not to provide false or misleading representations (s1041E of the Corporations Act or s12DB of the ASIC Act).*

  Personal advice attracts additional consumer protection obligations under Chapter 7 of the Corporations Act, for example, the requirement to provide a Statement of Advice (s946A) and the best interests obligation (s961B).

  Advice given at seminars or promotional dinners is more likely to be general advice. However, if the presenter has a one-on-one conversation with a retail client, for example, there may instances in which this would be personal advice if the presenter takes into account one or more of the person's objectives, financial situation and needs in giving that advice.

- Is it possible/likely that potential investors could interpret such advice as directed at them personally and hence be unaware that the consumer protections attached to the provision of financial advice did not apply?

  A person giving general advice must provide a warning to retail clients that the advice does not take into account the client's objectives, financial situation or needs, that the client should consider the appropriateness of the advice before acting on the advice and that the client should obtain a copy of the relevant Product Disclosure Statement: s949A of the Corporations Act.

  This warning must be given at the same time as the advice and by the same means by which the advice is provided. This means that when presenting

7 Name withheld, *Submission 96*, p. 1; *Confidential Submission 115*, p. 3.

general advice at a seminar or promotional dinner, we would expect presenters to provide the general advice warning as part of the presentation to ensure it is clear from the outset that the advice does not take into account the client's personal circumstances.

The objective of the warning is to ensure that clients understand the nature of the advice they are receiving. If the warning is not given (or not properly given) or the client does not understand the warning, it is possible that a potential investor could interpret general advice at a seminar or promotional dinner to be directed at them personally.

- Does ASIC see a need for improved consumer protections provisions around this type of promotional activity? Could you provide details?

  As part of our submission to the Financial System Inquiry Interim Report, we suggested that renaming general advice that is primarily directed at generating sales would better reflect the nature of the activity and would assist in clarifying its purpose for consumers. The recent Financial System Inquiry Final Report also supported the renaming of this type of general advice (recommendation 40).

  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. See our information on MoneySmart under 'Investment Seminars – Tricks and Traps'.

Referral networks

7. 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 are at stake because this advice 'does 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 and disclosure of the legal and regulatory framework of the consumer interaction[8]

- Could ASIC respond to these concerns about referral networks, how they operate, where they fit into the consumer protection regime?

8 *Submission 161*, p. 3.

A person who carries on a financial services business must hold an AFS licence, or be authorised under another person's AFS licence, unless an exemption applies (s911A of the Corporations Act 2001 (Corporations Act)).

Regulations 7.6.01(1)(e) and (ea) provide exemptions from the requirement to hold an AFS licence where a person informs a client that an AFS licensee or a representative of an AFS licensee is able to provide a particular financial service, or class of financial services, and provides the client with the relevant contact details. This would cover the scenario where, for example, an accountant (or any other person) refers a client onto a financial adviser to receive financial product advice; the act of referring the client would not require the holding of an AFS licence. Any services provided beyond this may fall within the AFS licensing regime (e.g. if advice is provided on the need or value of particular products the licensee gives advice on).

Where the referring person is not a representative of the AFS licensee or representative of a related body corporate, the person is required to disclose to the client any benefits they, or an associate, may receive as a result of the referral. This disclosure must be done by the means in which the advice to refer the client is given (e.g. if in writing, the disclosure would also need to be writing).

Once the client is referred to an AFS licensee (or representative of an AFS licensee), the financial product advice given to the client is subject to the conduct and disclosure obligations in Chapter 7 of the Corporations Act. As set out in our answer to Question 6, for example, if personal advice is given to the client, the advice must be in the best interests of the client (s961B of the Corporations Act).

Both the person giving the advice and the person referring the client must also not engage in misleading or deceptive conduct (s1041H of the Corporations Act or s12DA of the Australian Securities and Investments Commission Act 2001 (ASIC Act)) and not provide false or misleading representations (s1041E of the Corporations Act or s12DB of the ASIC Act) about financial services or products.

Role of accountants providing financial advice

8. A number of people providing advice on agribusiness MIS were accountants. One submitter drew attention to the blurring of responsibilities between the roles of an accountant and a financial adviser providing financial advice. In one submitter'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'.[9]

9 *Submission 118*, p. 6.

Furthermore, the accountants were often authorised to provide advice by the scheme's promoter. Another couple said that their adviser was their 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.

- Could you explain in detail the regulatory regime governing accountants providing financial advice, especially in the context of providing tax advice?

  Generally, a person who provides financial advice needs to either:

  (a) hold an Australian Financial Services (AFS) licence; or

  (b) become a representative of an AFS licensee, and provide financial advice on their behalf.

  However, there are a number of exemptions from the need to be licensed, including for accountants providing tax advice on financial products, asset allocation advice and investment strategy and services relating to self-managed superannuation funds (SMSFs).

  Tax advice

  Accountants may provide advice that relates to the taxation implications of financial products and that also includes financial product advice without holding an AFS licence, providing they meet certain conditions (reg 7.1.29(4)):

  (a) an accountant must not receive a benefit as a result of their client acquiring a financial product mentioned in the advice (other than the remuneration they receive directly from the client or someone associated with the client); and

  (b) if the client is a 'retail' client, an accountant must also provide a statement warning them that:

    i. the accountant is not licensed to provide financial product advice under the Corporations Act;

    ii. taxation is only one of the matters that must be considered when making a decision on a financial product; and

    iii. they should consider taking advice from an AFS licensee before making a decision on a financial product.

  This exemption permits an accountant to provide financial product advice on a financial product so long as this advice is merely incidental to the tax advice the accountant is providing, and not a separate recommendation on the merits of the financial product itself.

Asset allocation and investment strategy

A person, including an accountant, is permitted to provide broad advice to their clients on asset allocation of another person's funds that are available for investment among one or more of the following:

- *shares;*
- *debentures;*
- *debentures, stocks or bonds issued, or proposed to be issued, by a government;*
- *deposit products;*
- *managed investment products;*
- *investment life insurance products;*
- *superannuation products; and*
- *other types of assets.*

The exemption for advice on asset allocation does not apply to a recommendation or statement of opinion that relates to specific financial products or classes of financial products (note to reg 7.1.33A). This means that, while an accountant can recommend that a client hold a certain proportion of their funds in one of the eligible product types (e.g. managed investment products), they cannot recommend that:

- *their client hold specific product (e.g. managed investment products issued by a particular company); or*
- *a particular class of product (e.g. managed investment products issued by companies in the agribusiness sector, generally).*

SMSF services

Currently, 'recognised accountants' (i.e. accountants who are recognised by certain professional accounting bodies)[10] are permitted to give financial product advice about acquiring or disposing of SMSFs under reg 7.1.29A of the Corporations Regulations 2001.

From 1 July 2016, all accountants will need to hold an AFS licence (or become an authorised representative of an AFS licensee) if they wish to give financial product advice about acquiring or disposing of SMSFs to their clients. However, accountants can still provide other types of advice and services without an AFS licence. For example, provided the appropriate warnings are given, an accountant may provide advice on establishing, structuring and valuing an SMSF without holding an AFS licence (reg

[10] 'Recognised accountants' are accountants who belong to CPA Australia, the Institute of Chartered Accountants Australia and the Institute of Public Accountants.

7.1.29(5)), including the process for establishing or joining an SMSF, and other related information, such as:

- *the practical steps that need to be taken to establish an SMSF;*
- *how to add new trustees and members to join an existing SMSF;*
- *the different ways an SMSF could be structured; and*
- *providing a valuation of an existing SMSF.*

- In your view, is there a blurring of responsibilities or conflict of interest where a tax adviser is also providing financial advice?

  The separate regulatory regimes governing financial advice and tax advice recognises that there may, at times, be an overlap between these services. However, the exemption from the requirement to hold an AFS licence or be authorised under an AFS licence to provide financial product advice when providing tax advice is quite limited. Therefore, there should not be a conflict of interest as a tax adviser providing financial advice will be governed by the requirements for all financial advisers. An appropriate consideration of the taxation consequences of any financial advice is important.

  Since the introduction of the FOFA reforms, financial advisers and accountants providing personal advice must act in a client's best interest and also prioritise a client's interests over their own. These new requirements should reduce any possible conflicts of interest 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.

- Could advice by a tax adviser to invest in an agribusiness MIS be classified as scaled advice, or another form of advice, not subject to all the requirements of those governing the provision of financial advice?

  Depending on the nature of the advice, advice by a tax adviser on the taxation implications of agribusiness MISs may be permitted without the requirement to be licensed, so long as there is no separate recommendation on the merits of the agribusiness MIS itself. However, in practice, this could be difficult to achieve.

  An adviser providing scaled personal advice is still subject to the same requirements as an adviser providing comprehensive personal advice, although the nature of the inquiries about a client's relevant circumstances may be adjusted to reflect the nature of the advice being provided.

- Are accountants subject to the same requirements as financial advisers providing financial advice? Have these requirements changed over the last 15 years? Has FOFA affected the consumer protection measures for clients of accountants giving financial advice?

  In general, accountants providing financial product advice are subject to the same requirements as financial advisers, subject to the exemptions listed above. Therefore, the same changes introduced by FOFA also apply to accountants.

  As discussed above, FOFA changed one of the exemptions for accountants. From 1 July 2016 recognised accountants can no longer provide advice on establishing or joining an SMSF without holding an AFS licence.

- The lending arrangements were an integral part of the investment package—what regulatory regime covered this activity when accountants were arranging such loans as part of the taxation benefits that would accrue?

  Under the current regulatory regime, could accountants be authorised representatives of an agribusiness MIS and provide product advice on that scheme without themselves having to obtain an ASFL?

  If the responsible entity of the agribusiness MIS held an AFSL with the authorisation to provide financial product advice, and the responsible entity considered that, among other things, the accountant had the necessary training and competence to provide financial product advice then yes, an accountant could be an authorised representative of an agribusiness MIS and provide financial product advice on that scheme without having to obtain their own AFSL.

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- Are there exemptions for accountants providing advice (such as investing in a MIS) that would release them from the best interest requirements?

  This depends on the nature of the advice being provided by an accountant.

If the accountant's advice falls within a particular exemption to be licensed, then the best interests duty would not apply. Similarly, if only general advice is provided, then the best interests duty does not apply.

However, if an accountant is providing personal advice, then the best interests duty will apply.

- Does ASIC have any concerns about accountants giving financial advice (such as to invest in an agribusiness MIS) and the regulatory regime around the provision of that advice?

  Subject to the exemptions in the Corporations Regulations, accountants are regulated under the same regulatory regime as financial advisers when providing financial advice. At present, our focus is more on SMSF advice being provided by accountants, given the new limited AFS licensing regime which will come into force on 1 July 2016. We consider that the boundaries between what is and is not permitted under the law are clear and it remains to be seen in practice how the accountants implement these requirements. In relation to financial advice to invest in an agribusiness MIS, we are not aware of significant current activity in this area.

Disclosure regime

9. Submitters at times referred to information contained in prospectuses and in Product Disclosure Statements.

- At the time growers were investing in agribusiness MIS (late 1990s to 2008), what was the distinction between a prospectus and a Product Disclosure Statement?

  During this period, there was a change in the disclosure regime that applied to the managed investment schemes. Previously, schemes were subject to prospectus disclosure. Since the introduction of FSR, managed investment schemes have been subject to PDS disclosure.

  Pre 1998 (prospectus regime)

  In the late 1990s, interests in managed investment schemes were regulated as "prescribed interests" which came within the definition of 'securities' and were subject to the prospectus disclosure requirements contained in Part 7.12 of the former Corporations Law until 1999. Subsequently, the Corporate Law Economic Reform Program Act 1999 (CLERP Act 1999) introduced changes to the disclosure requirements by replacing Part 7.12 with Chapter 6D of the Corporations Act. The prospectus requirements applied to managed investment schemes until 2002.

Introduction of FSR regime – Product Disclosure Statements

In 2002, the Product Disclosure Statement regime was introduced by the Financial Services Reform Act 2001 (which commenced on 11 March 2002) for financial products.

As noted in the Revised Explanatory Memorandum to the Bill for the Financial Services Reform Act 2001, the reason why managed investment schemes were removed from the prospectus requirements and subjected to the Product Disclosure Statement regime, which also apply to superannuation and the investment components of life insurance (paragraph 14.21 of the EM), was to achieve regulatory neutrality as between the competing investment vehicles of managed investments, superannuation and the investment components of life insurance.

Differences between prospectuses and PDSs

The general disclosure requirement for prospectuses under s710(1) is that it must contain "all the information that investors and their professional advisers would reasonably require to make an informed assessment of the matters set out in s710. This includes the rights and liabilities attaching to the securities offered, the assets and liabilities, financial position and prospects of the issuing body. Information must be included only if a person whose knowledge is relevant (e.g. the issuer, a director, underwriter) actually knows the information or, in the circumstances ought reasonably to have obtained the information by making enquiries.

For PDSs, the disclosure standard is different in that the PDS requirements take a more directed approach. There is a list of matters that must be disclosed. This is supplemented by a limited general disclosure requirement to include 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 (s1013E). The information is information that is actually known to the issuer or seller. Also, information does not need to be included in a PDS if it would not be reasonable for a retail client to expect to find that information for the purpose of considering whether to acquire the product.

In summary, prospectuses have an extended disclosure requirement under s710(1) to include information that in the circumstances ought reasonably be obtained by making enquiries (often referred to as a due diligence requirement). While there is a requirement to include in a PDS information that might materially influence an investor's decision to acquire the product, this is not the same as the requirement under the prospectus regime to undertake extensive due diligence to discover all material information (see paragraph 14.74 of the Revised Explanatory Memorandum to the Financial Services Reform Act 2001). Despite this, PDS due diligence is still necessary in view of the defences to civil and criminal liability under s1021E(4) and s1022B(7) which requires that reasonable steps were taken to ensure that the disclosure would not be defective.

Also, there is no requirement for a PDS for an unlisted scheme to be lodged with ASIC. PDSs do not expire, but are required to be updated for material changes. A PDS must only be lodged with ASIC if the product in question is a listed managed investment product. For other financial products (such as unlisted managed investment products), ASIC is notified that a PDS is 'in-use'. Prospectuses on the other hand must be lodged with ASIC (s718) and expire 13 months after the date of the prospectus (s711(6)).

- Were any significant changes made to the requirements governing these documents during this period?

  The most significant change was the transition of managed investment scheme disclosure from the prospectus to the Product Disclosure Statement regime. During this period, there were no significant changes to the prospectus requirements.

  There have been no substantive legislative changes in the PDS regime that specifically applies to agricultural schemes. Since the introduction of the PDS regime, we note that for all managed investment schemes, a 'short-form' PDS disclosure regime was introduced in 2005. Under these changes, it is permissible to provide investors with shorter PDSs or to incorporate other material by reference. These changes did not remove the need to provide a full PDS but allows a shorter PDS to be given to investors, subject to investors being able to request a full PDS if they wish. Like the short-form prospectus, the shorter PDS aims to reduce the complex disclosure that investors receive.

10. One of the main defects that witnesses identified in the PDS involved projected yields. Some in the agribusiness industry raised concerns about overly optimistic yield projections during the early 2000s. Indeed, since 2001, some in the industry have expressed concern that many agribusinesses were making excessively optimistic, if not misleading, projections of future product yields and marketability in their prospectuses.[11]

- Was ASIC aware of concerns about the accuracy of the material which appeared in MIS prospectuses which cited 'some very ambitious yield forecasts'.[12] Could ASIC provide details?

11 See for example, van Eyk Capital, Senate Economics Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection,* Final report, February 2002, paragraph 4.64.

12 See for example, submissions from Sam Paton & Associates Pty Ltd; Evan D. Shield

ASIC has been aware of concerns about the forecasts contained in prospectuses and PDS documents. We have identified these issues in the past through our review of these documents. Such reviews can occur as a result of the lodgement of the documents with ASIC (where applicable), through our risk based surveillance, or as a result of complaints or reports of misconduct we have received.

We have conducted a review of complaints received during the period 2000 to 2008 and identified 28 complaints that contained expressions such as yield, forecasts, agribusiness, forestry or projected yields. Of these no further action was taken in relation to 11 due to insufficient evidence or the information did not indicate the concerns were of a serious nature. The remaining matters were either closed or referred for surveillance.

ASIC has responded to these concerns by setting out clear regulatory guidance on ASIC's approach to the use of prospective financial information (including financial forecasts and projections) in a disclosure document or Product Disclosure Statement (PDS). This guidance is contained primarily in RG 170. The current version of RG 170 was issued on 1 April 2011 and is based on legislation and regulations as at 1 April 2011. It was originally issued on 6 September 2002. Earlier guidance on the issue of financial forecasts was contained in Superseded Practice Note 67 Financial forecasts in prospectuses, issued 17 October 1996, updated 4 August 1997.

In addition we engaged an expert in agribusiness to provide industry benchmarks that would be useful to people considering an investment in olives and issued a safety check-list for people considering investments in these schemes. Media Release 01-298, 'ASIC gives good oil on olive schemes' provided the following statements:

> *'To assist potential investors, ASIC engaged an expert in agribusiness to provide industry benchmarks that are a useful guide to people considering an investment in olives.*
>
> *Such investments are generally at the riskier end of the spectrum and it's therefore important for consumers to understand what they might be getting into.*
>
> *The benchmarks provide a guide to people who are considering an investment in this currently popular area. They will help people determine the risks involved and the merits of claims of various schemes.*
>
> *They are not a substitute for seeking appropriate professional advice as to the suitability of the investment for a person's particular needs and financial circumstances.'*

ASIC has also taken action in a number of instances where long-term forecasts promoted by REs of agribusiness schemes did not appear to have a reasonable basis, including, for example:

- *ASIC Media Release 01-025, 'ASIC gets gruff on goat scheme prospectus';*
- *ASIC Media Release 01-229, 'Exotic Timbers lodges supplementary PDS';*
- *ASIC Media Release 01-297, 'ASIC acts on disclosure documents';*
- *ASIC Media Release 01-350, 'ASIC stops Cattle Fund prospectus';*
- *ASIC Media Release 01-402, 'ASIC acts to protect farmers in Carbonne Limited agricultural schemes';*
- *ASIC Media Release 01-413, 'ASIC places interim stop order on Cattle Fund prospectus';*
- *ASIC Media Release 01-451, 'ASIC takes action to protect investors';*
- *ASIC Media Release 01-440, 'ASIC issues guidance on forecasts';*
- *ASIC Media Release 02-09, 'ASIC pause over wine prospectus';*
- *ASIC Media Release 02-98, 'ASIC acts on olive forecasts';*
- *ASIC Media Release 02-99, 'ASIC trawls through oyster scheme';*
- *ASIC Media Release 02-111, 'ASIC shucks oyster project';*
- *ASIC Media Release 02-129, 'ASIC achieves greater disclosure in olive prospectus';*
- *ASIC Media Release 02-160, 'ASIC cuts down timber forecasts';*
- *ASIC Media Release 02-164, 'ASIC axes blue gum prospectus';*
- *ASIC Media Release 02-177, 'ASIC acts on four prospectuses';*
- *ASIC Media Release 02-194, 'ASIC takes action on prospectuses';*
- *ASIC Media Release 02-285, 'ASIC issues interim stop orders under new product disclosure statements regime';*
- *ASIC Media Release 02-304, 'ASIC issues interim stop orders';*
- *ASIC Media Release 02-323, 'PS170 Prospective financial information';*
- *ASIC Media Release 03-131, 'Crackdown on long-range forecasts';*
- *ASIC Information Release 04-71, 'ASIC issues guidance on PDS disclosure'; and*
- *ASIC Media Release 06-271, 'ASIC concerned over misleading use of past performance information in ads'.*

ASIC's FIDO website also contained a statement that,

> *"Forecasts are projections of the company's financial results. As such, you should keep in mind that they are projections and not actual results. Always scrutinise very closely the assumptions made by the company in*

forecasting its future profits and asset levels. The company should disclose in the prospectus:

- *What assumptions are made in preparing the forecasts;*
- *Information about how likely it is that the assumptions will occur; and*
- *The effect on the forecasts if the assumptions vary."*

11. The committee notes the conclusions reached by Mr Garry Bigmore QC and Mr Simon Rubenstein, Barrister at the Victorian Bar, who wrote of the practical difficulties for investors bringing claims for relief for defective PDSs, including:

> An overly prescriptive, complex and poorly drafted liability regime in Pt 7.9 of the Corporations Act. 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.

12. In their words, it is 'a prime illustration of confusing legislative drafting'.[13]

- Based on ASIC's experience, are there the practical difficulties bringing claims for relief for defective PDSs? Does ASIC have suggestions for improvement in the drafting?

  In the main where, ASIC identifies a defective PDS, it exercises its power to issue a 'stop order', an administrative mechanism that allows ASIC to prevent offers being made under a disclosure document, rather than bringing claims on behalf of investors for relief.

  ASIC recognises that the liability regime in part 7.9 that sets out the consequences for failure to comply with the various obligations with respect to a PDS, including giving a defective PDS, and its interaction with the consumer protection provisions in the ASIC Act are relatively complex and may be difficult to navigate.

  For example, the Timbercorp and Great Southern class actions failed because in each case it was found that:

  a. the impugned PDSs were not defective, in that they did not contain misleading statements or omit information that should have been disclosed; and
  b. 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.

13 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.

ASIC's experience of regulating retail financial markets indicates that 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.

While disclosure is necessary for arming investors and financial consumers with key information to guide decision making, certain limitations mean that it is not always sufficient for this task. ASIC addressed these issues extensively in its submissions to the Financial System Inquiry. See in particular ASIC's submission dated April 2014 at pages 31-44.

Experts' reports

13. In its submission, ASIC noted that in the past it had seen that:

> …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.[14]

- In light of this statement, could ASIC explain the regulatory regime around RE's commissioning experts to rate a scheme, (which is then included in the PDSs) and the responsibility, and accountability of, both the RE and the expert (or research house) for ensuring that the information is correct and reliable?

  It is important to note that the research report provider and the RE each have obligations under their respective AFS licences, including the obligation to manage conflicts of interest. In the context of a research report provider rating a scheme, 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.

  It is also important to note that two types of reports are produced, which are used and regulated in different ways:

14 *Submission 34*, paragraph 151.

- *Expert reports - which the scheme commissions to inform them about yields; and*
- *Research reports - which may be prepared independently of the scheme or which the scheme may commission to rate the scheme.*

With respect to the inclusion of such ratings and reports in PDS documents, ASIC is not aware that this is, or has in the past been a common practice. While advertising material and PDSs may state that the product has been rated, advertising material is more likely to contain the rating, while the PDS is more likely to refer to the fact the product has been rated and perhaps state the associated costs.

Expert reports

Where the expert report does not include an opinion on a financial product, for example, an MIS, the expert is not required to hold an AFS licence. ASIC is not in a position to challenge the views of these 'independent experts', as ASIC is not an expert on such matters.

Where the expert report includes an opinion on a financial product, for example, an MIS, the expert must hold an AFS licence and is subject to the obligations for AFS licensees and also meet the general conduct obligations such as the prohibition on misleading and deceptive conduct. This would mean for example that they may need to provide a financial services guide in some circumstances and have adequate dispute resolution systems and PI insurance arrangements. On the other hand, an exemption may apply if the expert is not rating the product but is providing an opinion about something other than a financial product, such as, for example, future timber prices.

If an expert opinion is included in a Product Disclosure Statement, generally the consent of the expert would be required (s1013K) and expose the expert to liability, if the information is misleading or has a material omission: s1021L, s1022B. If passed on with the expert's express or implied authorisation outside the PDS, the expert may have liability also under the Corporations Act and ASIC Act.

An expert who carries on a business of providing product ratings which are financial product advice, is restricted from assuming or using the term independent unless they meet particular requirements to demonstrate they are in fact independent under Div 10 of Pt 7.6.

Research reports

Research report providers perform an important gate keeping function in the industry by:

- *Identifying products to consider for inclusion on approved product lists*
- *Assisting financial advisers to formulate personal financial advice, and*
- *Providing research for use directly by retail and wholesale investors.*

Research is relied upon by both retail and wholesale investors and it is important to note that there is significant diversity among research report providers in terms of business models, researched products and client groups. For example, producers of research include investment banks, stockbrokers and specialist research firms which produce research on either a subscription basis or on a commission basis.

ASIC considers a research report to be general advice that is prepared and distributed to inform the investment decisions of retail and wholesale clients. Research report providers must hold an AFS licence and is subject to the obligations for AFS licensees and also meet the general conduct obligations such as the prohibition on misleading and deceptive conduct.

ASIC sets out its expectations of research report providers in RG 79. We consulted extensively with industry and other stakeholders before releasing RG 79 in 2012. Our objective was to:

- *improve research quality and transparency;*
- *improve compliance with conflicts management requirements setting out specific guidance as relevant to research providers about avoiding, controlling and disclosing conflicts of interest; and*
- *set out our expectations of users of research to ensure they do appropriate due diligence.*

- Could you elaborate on this statement in respect of agribusiness MIS and explain the reasons for the high ratings (especially on high yields) and, where overly optimistic or unrealistic, why were they not corrected?

  Where REs seek expert opinions in support of yields, ASIC is not in a position to challenge the views of these 'independent experts', as ASIC is not an expert on such matters.

  *We have enhanced the disclosure required under Regulatory Guide 232 Agribusiness Managed Investment Schemes: Improving disclosure for retail investors (**RG 232**) to require additional information about any experts and their forecasts. It should be noted, however, that some of this information was already required under our existing RG 170.*

As the corporate regulator, we ensure that REs and regulated entities, such as research report providers, meet their obligations under the Corporations Act.

The AFS licensee responsible for the research report may engage an expert whose opinions are relied upon. As noted above, however, the providers of certain expert reports are not subject to the AFS licensing regime.

We expect AFS licensees (including advice providers) to conduct appropriate due diligence in choosing a research report provider[15] Our guidance is designed to assist and support licensees and advice providers in the process. This is particularly important where general advice prepared by research report providers is relied upon in preparing approved product lists. Not all research is the same and we expect AFS licensees who provide personal advice to apply requisite level of rigour in assessing the quality of the research when preparing personal advice.

- What incentives and sanctions now exist for research houses and experts to make sure that their ratings are objective and well founded? Does ASIC see a need for stronger regulations or sanctions in this area?

  As with all AFS licensees, 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. The sanctions that apply for breaches of licence conditions include administrative law sanctions from licensing cancellation, the imposition of licence conditions, through to negotiated improvements in compliance behaviour such as training, conflicts management etc. Such agreements can be formal licence conditions or negotiated agreements such as EUs. Depending on the conduct, ASIC act sanctions range from infringement notices through to civil penalties.

  In terms of ASIC's ongoing work in relation to research report providers, we monitor compliance as part of our ongoing supervision.

- Under current legislation, what are the disclosure requirements or other restrictions on product issuers engaging so-called 'independent experts' to rate their products and to publish their findings and ratings?

  Our reading of the current law is that there is no clear and distinct requirement regarding the engagement of independent experts, nor does the law set out a detailed prescriptive approach to their use.

  Within this regime, we provide guidance in RG 170.33 in relation to the engagement of an independent expert. An independent industry expert must

[15] See RG 79.176 on Due Diligence

have the credentials to give an opinion on the issue of whether reasonable grounds exist for the prospective financial information. These credentials might be shown by the expert's specialised training, study or experience. The subject matter of the report must not be outside the scope of the expert's relevant field of expertise.

We also explain that an expert's report is unlikely to be of assistance in establishing the existence of reasonable grounds for prospective financial information if the facts that the expert has relied upon are unverified or unverifiable. If an expert relies on information provided by third parties, they should indicate if they have any reservations about accepting that information as accurate because they will often be in the best position to decide if the information warrants further inquiry.

- In ASIC's view are the integrity and honesty obligations placed on research houses or independent experts who provide advice that is included in disclosure documents such as the PDS, sufficiently strong? Can ASIC identify areas where they could be strengthened if deemed necessary?

  Research report providers must comply with the general licensing obligations and the requirements set out in RG 79. It should be noted that ASIC has not reviewed the conduct of research houses since the last revision of RG 79 in December 2012.

  We consider research report providers to be important gatekeeper in the market and expect them to meet their obligations. Where this does not occur, we can take action and where we find the current policy settings are not meeting our objective to improve the transparency and comparability of investment research, we will consider the need to impose licence conditions on AFS licensees providing research reports.

Winding-up failed MIS

14. The winding up of agribusiness MIS has encountered many practical difficulties not contemplated by current legislation and exposed the complexities in disentangling the rights and obligations of the various parties.

- Based on your experience with failed agribusiness MIS, can you suggest measures that would make the winding up of MIS far less complicated?

  In relation to the winding up of unviable agribusiness schemes, ASIC considers there are a number of areas that could help to make the winding up of these schemes less complicated. These are outlined in ASIC's submissions dated September 2011 in response to the CAMAC Discussion Paper: Managed investment schemes (2011) and include:

- *Obligations on the responsible entity to identify and record the affairs of the scheme and a system for recording agreements that are connected to the scheme. Based on ASIC's experience, a requirement to maintain a register of the agreements that underpin or form part of the scheme (that is, contracts under which any aspect of the scheme's program or plan of action is carried out) would be beneficial in helping the relevant parties (members, creditors, ASIC and the courts) to determine the scope of the scheme.*
- *A requirement to maintain an up-to-date register of scheme property that identifies what property belongs to the scheme, and whether property that is used in connection with the scheme belongs to the scheme, the responsible entity or members. This is to address the fundamental difficulty in determining what scheme property is, and is not, in the scheme.*
- *Extending the time period (currently 28 days) for members to be able to call a meeting to consider a winding up or permitting members to respond directly to the responsible entity about whether they would like a meeting to consider the winding up. These go to facilitating the process for members to consider whether the scheme should be wound up.*
- *Broader powers for the administrator or liquidator of the responsible entity to apply for court orders to have a scheme wound up.*
- *In situations where an insolvency practitioner is appointed to the responsible entity, a voluntary administration regime (akin to Part 5.3A that applies to companies) could assist with the process of determining whether a scheme should be wound up. Such a process may help resolve some issues about the extent of members' and third party rights without court involvement.*
- *Providing powers to creditors, members and ASIC to inspect the liquidator's books to ensure transparency in the liquidation process.*

15. CAMAC has undertaken a very thorough examination of managed investment schemes and produced many recommendations that would address identified weaknesses when it comes to dealing with a financially distressed MIS company and if necessary the winding up of such a company. Importantly it noted that:

> 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
- clear identification of scheme property and its separation from the proprietary interests of scheme members utilised in the schemes.

- Does this assessment match ASIC's?

  This assessment is consistent with ASIC's views so far as common enterprise schemes are concerned (see ASIC's submission dated September 2011 to the CAMAC Discussion Paper: Managed investment schemes (2011) on this point in relation to incapacitated responsible entities of unviable schemes). In principle, ASIC accepts that the responsible entity must, for each common enterprise scheme maintain a definitive register of affairs of the scheme and a definitive register of property of the scheme.

16. In its submission, ASIC noted:

> The Corporations Act imposes an overriding duty on the responsible entity and its officers under s601FC and 601FD to act in the best interests of the members of the scheme and prefer the members' interests if there is a conflict. This duty has been considered by the courts as to the position of liquidators winding up a responsible entity.[16]

- How does the liquidator's duty to members of the scheme sit with the liquidator's duty to secured creditors?

  As outlined in our submission to the Inquiry at paragraphs 130 – 133, case law suggests that as a fiduciary, the liquidator must act impartially between all those who are interested in the winding up. This has been applied by the courts as meaning the liquidators have imposed on them a duty to act at all times with complete impartially between the various persons interested in the property and liabilities of the company.

  In practice difficulties arise in managing the tension between the liquidator's obligations to scheme members, who may be unsecured creditors and their obligations to the secured creditors of the responsible entity.

Some misconceptions

17. ASIC states in its submission that 'it is generally accepted that in forestry schemes the trees on the land are usually the property of the individual growers'.[17]

- Does the same apply to the agribusiness MIS—does the grower own the plants or just the crop at harvest?

16 *Submission 34*, paragraph 129.

17 *Submission 34*, paragraph 40.

It is generally accepted that in a horticultural scheme, the crops are owned by the individual growers, as opposed to the whole plant. In the case of forestry schemes, the trees themselves would generally be considered to be the crop, and therefore owned by the individual investors.

- Would a grower have been able to identify the trees he/she owned?

  In our experience, REs would typically designate the plots which are owned individual investors within plantations, as growers would need to be able to identify their lots for taxation purposes. We would expect, and generally found it to be the case that REs would designate lots in this way. The extent to which this was accurate, however, would depend on the quality of record-keeping functions maintained by the REs.

- What is the situation of investors who invested in 2008 just before the MIS collapsed and before their trees/plants were planted—could they have a claim that because their trees/plants were never planted their agreement with the RE is void?

  Whether or not the agreement(s) between an investor and RE is void or voidable, when entered into in the circumstances described above, will depend in each case on the specific agreement(s) entered into with the RE and all of the circumstances surrounding the investor's entry into those agreements, including the quality and extent of disclosure that was made. The scheme constitution, compliance plan and any other agreements between investors, the RE and any relevant third parties may also be relevant. The operation and effect of all of these documents will determine the circumstances in which and nature of any action or claim that an investor in the scheme may have, including in the circumstances described above.

- Could ASIC elaborate on the confusion arising out of the rights of the growers, the landholders (farmers) who leased the land, and the secured creditors once a liquidation was in train? Who had a right to what?

  The question as to "who had a right to what" in the liquidation of an agribusiness scheme depends on the terms of the agreements between the growers and secured creditors with each other and other interested persons, including the RE. The scheme constitution, compliance plan and any other agreements between investors, the RE and any relevant third parties may also be relevant.

18. In its submission, 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'. Further:

> The Corporations Regulations 2001 (Corporations Regulations) mandate that the key form of compensation an AFS licensee must have is an acceptable contract of PI insurance.

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.[18]

- Could ASIC respond to this observation?

Overview of the current compensation arrangements

The Corporations Act (s912B) provides 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.

The Corporations Regulations mandate that the key form of compensation arrangement required by a licensee is adequate PII.

Regulatory Guide 126 Compensation and insurance arrangements for AFS licensees (RG 126) sets out the key features a PII policy must have for it to be 'adequate'.

Concerns with the current compensation arrangements

ASIC and others including industry associations, FOS and consumer groups have raised the shortcomings of PII as a compensation and consumer protection mechanism in a number of government inquiries and reviews including most recently the FSI.

PII is designed to protect licensees against business risk, and not to provide compensation directly to investors and financial consumers. 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. Also, insurers who provide PII cover do so on a commercial basis giving rise to issues including practical availability.

18 *Proof Committee Hansard*, 6 August 2015, p. 29.

ASIC monitoring of licensees' PII arrangements

ASIC does not "approve" PII arrangements and does not require evidence of annual or other periodic renewal of PII cover. We do not have the resources that would be required to review licensees' PII policies on an annual basis to determine whether they are adequate including taking into account each licensee's other financial resources. We do, however:

- *consider AFS licence applicants' PII arrangements (on application);*
- *conduct surveillance on licensees as risk warrants; and*
- *maintain a dialogue with stakeholders regarding any issues that might give rise to regulatory risk that licensees may not hold adequate PII. We have recently completed a project to gather information regarding the state of the PII market. We intend to release our review findings before the end of 2015.*