# 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.

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 must 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.