

# Chapter 1

## Introduction

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

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

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

### Conduct of inquiry

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

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

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

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

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

## **Terms of Reference**

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

## **Background to inquiry**

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

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

1.11 Since the collapses, significant reforms have been introduced that address some of the problems associated with the schemes, particularly the provision of poor financial advice. They include the Future of Financial Advice (FOFA) reforms, which have introduced robust measures to strengthen consumer protection, such as the banning of conflicted remuneration and obligations to act in the best interests of

clients. Some of these major reforms have not yet fully come into effect, while others are still under active and further consideration. In this regard, the Australian Bankers' Association recently stated that the financial advice industry was in a state of transition:

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

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

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



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

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

## **Submissions**

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

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

## **Confidential material**

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

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

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

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

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### ***Adverse comment***

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

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

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

### **Scope and structure of report**

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

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

### ***Introduction and background to MIS***

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

***Part I—Retail investors and incentives to invest***

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

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

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

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

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

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

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

**Acknowledgements**

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

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

