

# Chapter 6

## Retail investors

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

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

### Behavioural economics

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

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

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

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

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

2 See chapter 3 and paragraphs 4.6–4.15.

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

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

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

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

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

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

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

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

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

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

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

9 *Financial System Inquiry, Final Report*, Commonwealth of Australia, November 2014, p. 215, [http://fsi.gov.au/files/2014/12/FSI\\_Final\\_Report\\_Consolidated20141210.pdf](http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf) (accessed 10 December 2014).

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

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## Trust

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

I trusted Holt Norman & Co with my family's future, but unbeknown to me these accountant/financial advisers were reaping huge commissions and bonuses while sinking me into enormous debt...

To some degree, I accept responsibility for my own predicament. I definitely should have asked for clarification about the documents I was asked to sign. But my consultations with Bill Norman were often informal and we would make light of my inability to understand investment schemes. He would reassure me that investments were his speciality and that I did not need to worry about the details. I only needed to sign and return any paperwork that arrived in the mail.<sup>13</sup>

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

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

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

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

13 *Confidential Submission 37*, p. 4.

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

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

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

17 *Confidential Submission 37*, p. 13.

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

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

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

6.12 Yet another spoke of being unaware that his adviser, with whom he thought he had a 'professional customer/client relationship' and held in a position of trust, could be involved in a situation best described as 'not morally right'.<sup>21</sup> Understandably, he argued that financial advisers should have been above reproach.<sup>22</sup> Mr Peter Mazzucato, an investor in Timbercorp, informed the committee that:

The only product that was discussed was MIS and in particular investments with Timbercorp. I had never hear[d] of MIS schemes prior to this. I did not know that there was any risk in investing in these schemes and confess to being totally naïve about investments outside of buying a house.<sup>23</sup>

6.13 Mr Mazzucato told the committee that after a short discussion his financial planner convinced him that Timbercorp would be a good investment. He was told that it was government backed; would provide an income stream for 23 years; was absolutely safe with no risk at all; and that literally thousands of people had been investing in these products for years. Consequently, Mr Mazzucato was eager to get involved with the scheme and, as with so many other investors, concluded—'After all, what was there to lose?'<sup>24</sup>

6.14 According to the growers who gave evidence to the committee, the advice sounded legitimate. As one grower told the committee, 'yes we were at fault as well;

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18 *Confidential Submission 154*, pp. 1 and 5.

19 For example, see name withheld *Submission 78*; name withheld, *Submission 151*, pp. 1 and 2; name withheld *Submission 152*, p. 1.

20 Name withheld, *Submission 152*.

21 Name withheld, *Submission 41*, p. 3.

22 Name withheld, *Submission 41*, p. 3.

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

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

for trusting, for believing and for following the advice we received'.<sup>25</sup> The sense of betrayal by a trusted adviser was a dominant theme with another suggesting:

We trusted this professional, unaware that he was acting as a sales representative for MIS recommending these investments motivated by his own financial plans rather than ours.<sup>26</sup>

6.15 Yet another told the committee that, at the age of 27, he tried to be sensible with his money and invest with the hope of purchasing his own house and ultimately, as a long term goal, of being a self-funded retiree. He was not sure of the best way to go about achieving his modest goal but assumed that 'a financial advisor and the laws governing them would help me invest my money in a smart and safe way'.<sup>27</sup> He was advised to invest in Great Southern grape vines 2007 and 2008, described by his adviser as a safe, government endorsed product with tax deductions, which, to the grower's mind, 'added to the security of the product'.<sup>28</sup> Another stated:

The way it was presented we believed (perhaps naively) that not only would we then be certain of being self-funded in our retirement but we would also be investing in Australia.<sup>29</sup>

6.16 Many simply could not fathom how they ended up in such a predicament, especially when they thought they had taken necessary precautions. One couple spoke of the stress that the entire system had caused and feared it was here to stay, and 'all because we did the right thing—earned money honestly, invested after expert opinion was sought, paid our taxes, saved for self-funded retirement within the guidelines'.<sup>30</sup>

6.17 Mr Peter Jack, investor in Timbercorp, who was advised by both his financial adviser and accounting firm, stated:

As the product was brought to us by our financial planner and then confirmed as a viable and legitimate product by our accountants we undertook to invest in Timbercorp with the opinion we had sought the right advice.<sup>31</sup>

6.18 Many investors assumed that they were receiving expert advice.<sup>32</sup> Voicing the experiences of many of the growers, one investor explained:

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25 Name withheld, *Submission 102*, p. [1] and name withheld, *Submission 4*, p. 1.

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

27 Name withheld, *Submission 70*, p. [1].

28 Name withheld, *Submission 70*, p. [1].

29 Name withheld, *Submission 71*, p. [1].

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

31 *Submission 25*, p. 1.

32 Name withheld, *Submission 100*, p. 13. They stated, 'We did not have the skills to develop a business under a future financial strategy, hence we went to so called 'experts' for advice'.

We did not have the knowledge, skills or expertise to independently scrutinize the advice we were given. We trusted the professional conduct of the adviser with which we dealt. We invested on this basis.<sup>33</sup>

6.19 In some cases, the trust had developed over many years especially with accountants who for years had been advising their clients on taxation. Mr John McDonald explained that, as a long standing client, he did not question the conduct of his adviser to the point where, in his own words, he would 'stupidly' not read documents thoroughly and would simply follow the directions "'Sign here; sign here". It's a done deal".<sup>34</sup> He explained:

That trust developed over 20-odd years, and the habit of not reading documents properly before signing them built up over a similar period.<sup>35</sup>

6.20 Trust was also a critical element in following the advice to borrow to invest in the schemes.<sup>36</sup> One couple informed the committee that after receiving advice they went home and crunched some numbers. At that point, however, they started having concerns as to how the numbers would work if they took out another loan, in addition to the 2007 scheme. According to the investor:

I started getting nervous. So back we went to Steve [adviser]. He truly was a great salesman. After showing him all my spreadsheets and concerns and explaining our situation we walked out of his office, having agreed to sign up to the 2008 scheme, our minds at rest that it would all be OK! To this day I have no idea how he persuaded us to do this. But he sounded so sure of himself and we trusted him completely as did many other of his clients who seemed astute and knowledgeable.<sup>37</sup>

6.21 A single, mature-aged woman informed the committee that she had received advice to invest in Timbercorp shares, \$50,000 worth, financed through Timbercorp Finance. She said:

Call me naïve, but I went to a financial planner as I expected that they would give me SOUND advice. By the time I signed the release form it was only days before the end of June 2008 and I had no awareness of the financial concerns.<sup>38</sup>

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

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

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

36 Name withheld, *Submission 4*; name withheld, *Submission 78*; Mr Con Solakidis, *Submission 119*, p. [2]; *Confidential Submission 92*, p. [2]; and *Confidential Submission 134*, p. [2].

37 Name withheld, *Submission 56*, p. [3].

38 Name withheld, *Submission 73* (emphasis in original).

6.22 Along similar lines, another investor, who was unaware of the need to take out additional loans for management fees, stated simply that she 'stupidly trusted her adviser'.<sup>39</sup> Yet another grower stated:

The thing I am most upset about is how I trusted the financial advisor, believed the Timbercorp documentation and advertising propaganda. It is clear the company was selling something they had no intention of delivering. If I borrowed money from a person selling a house and I did not get the house they would not get any money, this is the same. Simple.<sup>40</sup>

6.23 Ms Michelle Johnson told the committee that she quizzed her adviser about the security and soundness of her proposed investment scheme. Before agreeing to the suggested level of commitment, she spoke with her adviser about being a single mother and how she did not wish to risk her financial security. Ms Johnson explained further:

I asked him outright if there was any risk of losing my home because I would not proceed if this could happen. He reassured me that this could not occur with his system. He stated his plan for me was long term investments for a tax effective income stream to be able to own my own home and be comfortable in my retirement, and that Timbercorp investments were endorsed by the ATO.<sup>41</sup>

6.24 Mr David Abraham stated simply that he took advice supported by the graphs his advisers produced, which showed 'the way tree harvesting would be able to repay interest and capital as well as give me a long term investment return'.<sup>42</sup> He referred to what appeared to be 'good financial advice'—charts, graphs, 'inspiring' seminars and 'hype' from Navra Financial Services and Great Southern.<sup>43</sup> One couple reported that their questions about the complex nature of the schemes and requests for more detail were greeted with reassurance that this was the adviser's 'field of expertise and that he would take care of things...'<sup>44</sup>

6.25 The same stories of investing in good faith on the understanding that the scheme would produce a good return in years to come were repeated with the following description just one of the many almost identical accounts:

We were told it was a scheme completely backed by the government to support Australian agriculture. The whole point of the investment according to Steve [adviser], was that it was self-funding and that we should not expect high Forestry managed investment schemes returns or pie in the sky

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39 *Confidential Submission 38*, p. 1.

40 Name withheld, *Submission 30*.

41 *Submission 139*, p. [1].

42 *Submission 64*, p. [1].

43 *Submission 64*, p. [1].

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

profits. It was sold to us as a conservative pension fund of sorts to assist in retirement with only a very modest return.

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We double checked with him what would happen if it all went belly up—we were told there was insurance to cover this, and there was no way we could lose on it. He re-iterated over and over that this was a safe, self-funding investment. We checked what we'd been told with Tony's boss who referred us to Steve, along with his extremely conservative accountant—same story.

We honestly thought we were investing in a nice, safe investment, a product that was endorsed and supported by Australian government legislation, and that nothing could go wrong.<sup>45</sup>

6.26 Mr Shane Richards captured the experiences and sentiments of many growers who wrote to the committee when he stated:

The plight of myself and many other borrower investors cannot be seen as just a group of dissatisfied people who took a gamble and lost, but a group of people who put their trust in what they were told and in the hands of the people charged with running the scheme...<sup>46</sup>

6.27 Clearly, investors formed the view that not only had advisers abused their position of trust but that the consumer protection regime had also failed them. As most of the small investors intimated, they did not have the knowledge, skills or expertise to scrutinize independently the advice they were given: they trusted the professional conduct of their adviser and invested on that basis.<sup>47</sup> One couple maintained those involved in selling the schemes:

...have received government licenses that authorise them to make what the ignorant investor believes are expert and well researched, personalised plans but...the sad reality today is that the Australian consumer has more protection buying an item that costs just a few dollars than when they invest thousands, even millions through these so-called professionals. Something needs to be done and these unscrupulous accountants/financial planners need to be held accountable.<sup>48</sup>

### ***Committee view***

6.28 Evidence before the committee highlighted the vulnerability of retail investors and their high susceptibility to a persuasive financial adviser. It underscored the importance of consumer protection. Indeed, this report abounds with accounts of

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45 Name withheld, *Submission 56*, p. [1]. See also Scott and Julie Gannon, *Submission 114*.

46 *Submission 108*, p. [2].

47 Mr Alexander McShane, *Proof Committee Hansard*, 6 August 2015, p. 3. Also *Confidential Submission 134*, p. [1].

48 *Confidential Submission 36*, p. [1].

investors following the advice of their adviser because they truly believed that the adviser was a professional: an expert who would act in their clients' best interests irrespective of economic incentives that might influence that advice.

6.29 It should be kept in mind that the examples provided in this chapter represent only a sample of the submitters who referred to the trust that they placed in their adviser. The committee cannot put a figure on the number of people who have suffered because of the inappropriate product promotion of MIS and the accompanying poor financial advice. Some investors conceded that they were gullible or naïve and should have done more to ensure that they were investing wisely but, without doubt, trust played a major role in persuading them to invest in MIS. In the following part of this report, the committee looks at the conduct of the advisers, promoters, product producers and financiers and their motives in marketing and selling these products to retail investors.

