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

The growers who took advice to invest in MIS were convinced of the soundness of their decisions and the integrity of those who marketed the schemes. As one grower stated it 'looked legitimate', asking 'After all, what was there to lose?' In this part of the report the committee examines the promotional aspects of MIS; the conduct of advisers who recommended the products; the developers and promoters who produced, managed and rated the schemes; the banks that lent to the investors and the lawyers who advised borrowers to cease repayments on their loans.

The committee considers weaknesses in the regulatory regime that left investors exposed to poor financial and legal advice.

Chapter 7

Financial advice and advisers

> We had no experience in this industry. However we trusted our accountants as we did not believe that they would be recommending an investment which was high risk and not in our best interests.[1]

7.1 Advisers occupy an influential position when it comes to the small investor making a financial decision. Australia's regulatory framework recognises the vulnerability of the retail investor to financial advice and places a heavy reliance on the conduct of advisers and on mandatory disclosure to protect retail investors from receiving bad advice.

7.2 As noted in the previous chapter, clients gave great weight to their advisers' recommendations and, even against their own inclinations, invested in inappropriate products that they did not fully understand. In this chapter, the committee looks at financial advisers and the regulatory framework governing their advice, in particular, its adequacy in protecting consumers from unsound advice.

Agribusiness and financial advice

7.3 Financial advice has a specific legal and regulatory meaning. Financial product advice means a recommendation or a statement of opinion, or a report of either of those things, that:

- is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or
- could reasonably be regarded as being intended to have such an influence.[2]

7.4 When most of the growers who made submissions invested in MIS, their financial advisers were required, under section 945A of the Corporations Act, to have a reasonable basis for advice. Until recently, this section, the so-called 'know your client' provisions, required advisers to recommend products in the light of their knowledge of clients' individual needs and circumstances.[3] In other words, the adviser must have been able to demonstrate that they complied with two central obligations—know their client and know their product. Licensees and their advisers were also required to ensure that the advice given to the client was appropriate.

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1 Mr Peter Tomasetti, *Submission 170*, p. 1.

2 *Corporations Act 2001*, s 766B.

3 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.39.

Deficiencies in advice

7.5 It is important to note that an awareness of shortcomings in the promotion and selling of agribusiness MIS date back to 2001 and 2002, when identifiable concerns about these schemes were surfacing. At that time, ASIC had formed the view that certain agricultural investment schemes often sold as tax driven schemes left 'much to be desired in terms of their marketing, promotion and operation'. It told the committee in 2001 that, as a percentage of the managed investments industry as a whole, the number of compliance problems in the agribusiness schemes area was high.[4]

7.6 In 2003, ASIC again expressed concerns about the quality of advice and disclosure in relation to the promotion of tax-effective mass-marketed schemes in the primary production managed investments sector. In particular, ASIC was aware of:

- the questionable commerciality of some of the schemes;
- at times, the poor quality and absence of adequate disclosure;
- occasional inappropriate or misleading advice; and
- payment of high commissions in excess of market norms for other retail investment schemes.[5]

7.7 Yet, over the next five years or so, interests in the agribusiness MIS continued to be promoted and sold, drawing in significant numbers of retail investors right up to the collapse of the major schemes. Evidence also shows that the problems known to exist in 2001 and 2003 persisted. The committee has provided many examples of advisers misleading their clients on the risks involved in investing in MIS or where they allowed, even encouraged, their clients to hold incorrect assumptions about the safety of the product and/or loan. Most of these advisers held an AFS licence or were an authorised representative of such a licensee.

Licensing requirements

7.8 Under the *Managed Investments Act 1998*, scheme promoters must hold a licence to operate the scheme and must obtain a separate authorisation in order to give advice relating to a scheme. The law allows a licensed dealer or adviser to issue a 'proper authority' to a representative, who is thereby authorised to act on behalf of the licensee. The licensed dealer has responsibility for ensuring that such representatives comply with the law and possess appropriate educational qualifications and experience.[6]

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4 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.46.

5 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 4.

6 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.40.

7.9 Furthermore, the licence holder is obliged to notify ASIC of any proper authorities that they issue and is responsible for ensuring that such representatives meet ongoing training requirements. ASIC maintains a register of all proper authority holders.[7]

Statement of Advice (SOA)

7.10 If personal advice is given to a retail client, the provider (i.e. AFS licensee or authorised representative) must give the client a statement of advice (SOA). An SOA must set out the advice and the basis on which it was given.[8] It must also contain:

- the name and contact details of the provider of the advice;
- information about any remuneration (including commissions) or other benefits that the provider and related or associated persons or entities may receive (these amounts must be disclosed in dollars unless otherwise permitted by ASIC relief); and
- information about other interests, associations or relationships that might be expected to be or have been capable of influencing the advice.[9]

7.11 The SOA, which is to assist a client understand, and decide whether to rely on the advice they have been given, must be given to a client when financial product advice is provided.[10] The CPA informed the committee that although ASIC expects that an SOA is set out in a clear, concise and effective manner, they have become:

> …an unnecessarily long and complex compliance document used by the industry as part of the audit trail for protection from potential litigation. SOAs—in their current form, do little to enhance the consumer's understanding of the advice they are receiving. While an SOA must be tailored to the needs of each client, one option may be to explore what efficiencies could be achieved through industry consultation.[11]

7.12 It should be noted that a number of investors mentioned that at the time of signing up for the scheme they were not provided with, or in some cases not aware of, SOAs, financial service guides or general advice warnings.[12] For example, Mr Huggins told the committee that he was:

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7 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.41.

8 *Corporations Act 2001* (30 July 2004), s 947B and s 947C.

9 *Corporations Act 2001* (30 July 2004), s 947C.

10 *Corporations Act* 2001, s 946C sets down the critical time frames for providing a Statement of Advice. (30 July 2004).

11 *Submission 142*, p. [2].

12 See for example name withheld, *Submission 151*, p. 1; Mr Shaun Ritchie, *Submission 159*, p. [2]; name withheld, *Submission 162*, p. 1; *Confidential Submission 8*, p. [1].

> …aware of instances where no SOA was provided at all…the SOA was provided after the investment was made or the SOA was grossly deficient (sometimes being little more than a marketing style document that has apparently been produced by the *promoter* of the *scheme*).[13]

7.13 The committee has already mentioned the confusion and apparent lack of investor awareness about their loan arrangements. One such couple indicated that they were in possession of very few SOAs and certainly none that stipulated that loans were to be taken out in their name without their knowledge and 'funded by our margin lending dividend bank account'. They explained that their adviser was doing exactly that and cited an SOA for Citrus 2004 which outlined a loan for $80,000 but they were unaware that loans were taken out in their name for citrus, almond and olive or forestry schemes.[14]

7.14 Furthermore, investors were poorly equipped to appreciate the information contained in the disclosure documents. One couple who did receive a SOA and PDS explained:

> We were never encouraged to read them or seek independent advice. We were led to understand that we were purchasing lots of units of trees. There was little information provided regarding the nature of the investment. The language of the Statement of Advice described our purchases as 'LOTS' and 'Grovelots'.
>
> As such we believed we were investing in physical assets that would provide some financial relief in the event of failure of the business.[15]

7.15 In particular, they noted that in their SOA there was no mention in sections on project specific risks and revenue and financial risks of their exposure to debt should the business fail.[16]

Inappropriate advice

7.16 Many growers who wrote to the committee contended that they were the targets of white collar crime.[17] The words they commonly used to describe the financial advisers and accountants who enticed them to invest in the failed MIS included dishonest, unethical and self-serving.[18] One investor maintained that she needed protection from a shonky product that was sold by 'an unscrupulous, greedy financial planner'—'merely a product salesman' who:

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13 *Submission 118,* p. 7 (emphasis in original). See also Mr Shaun Ritchie, *Submission 159,* p. [2].

14 Name withheld, *Submission 100,* p. 2.

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

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

17 *Confidential Submission 37,* p. 1; *Submission 54,* p. [1].

18 Mr Giles Lynes, *Submission 113,* p. [2]; *Confidential Submission 37,* pp. 1 and 2; *Confidential Submission 15,* p. [2].

> …did not have my interests at heart. We need another system to protect consumers![19]

7.17 Another couple, who also saw themselves as victims of an unprincipled financial advisor, informed the committee that their adviser had 'a one size fits all' approach to his clients.[20] They suggested:

> We received inappropriate and misleading advice for our situation as retirees, being balanced investors seeking a modest income so we would not have to rely on a government pension.[21]

7.18 According to one grower, Timbercorp never hinted at any danger or risk to their investments. He went on to state that the only worrisome risks were fire, windstorm and hail which were covered by the yearly insurance payment. His adviser:

> …acknowledged all investments have risks but they were minimal and to give additional weight to her advice she said she was putting her money in as well.[22]

7.19 Similarly, another couple informed the committee that they enquired about the risks but were told if there were any issues the RE would change hands and their investment would be safe unless there was a long term drought, which made sense to them at that time.[23] Some investors were told that their investment was conservative and there was 'guaranteed income'.[24] Another couple informed the committee that their adviser had encouraged them to mortgage their freehold home and investment properties and to use the funds to invest in these tax deductible schemes.[25]

7.20 The overwhelming view among the growers who wrote to the committee was that the products should not have been offered and sold to them.[26]

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19 Name withheld, *Supplementary Submission 52.1*, p. [2].

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

21 Name withheld, *Submission 65*, p. 1. See also Mr Peter Mazzucato, who identified major flaws in the advice he received from his financial adviser. The adviser did not provide him with a cash flow analysis, arranged a loan that was way above Mr Mazzucato's ability to pay based upon his income at that time. Also, the financial planner did not tell Mr Mazzucato about the ongoing costs of the loan. *Submission 40*, p. [2].

22 *Confidential Submission 36*, p. [6].

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

24 *Confidential Submission 125*, p. [1].

25 *Confidential Submission 36*, p. [4].

26 *Confidential Submission 35*, pp. 1–2*; Confidential Submission 115*, p. 3; *Confidential Submission 128*, p. 1.

Inappropriate risk for investor profile

7.21 A number of submitters were unaware of the risky nature of the investment indicating that their adviser conveyed a very different impression.

7.22 One of the most concerning aspects of the advice was the disregard shown for the investor's risk profile and interests. Many suggested that the advice was inappropriate, unsound and contrary to their financial situation: that they were poorly advised and their adviser lacked duty of care.[27] They spoke of how their financial planner ignored their risk profile: that they were placed in a high risk investment when they required a low risk one. Mr Mazzucato informed the committee that his financial planner classified him as a 'sophisticated investor'. When he told his accountant of this fact, the accountant was shocked and advised Mr Mazzucato that to be deemed a sophisticated investor he needed assets of over $2.5 million and an income in excess of $250,000 per annum—both of which were far from the case at the time.[28] One man informed the committee that:

> My wife's risk profile was determined to be 'conservative' and yet our financial planners within the Navra Financial Services/Navra Group Pty Ltd inappropriately advised us to invest our funds in highly-geared, high risk investments on high interest rates even though my wife was not in a working capacity. We are not financial planners and therefore we trusted their advice.[29]

7.23 Overall, in their assessment the financial planning industry was one where:

> …hardworking Australians, everyday mums and dads, are being duded by predators, wolves dressed up as lambs, who prey on their innocence and lack of knowledge.[30]

7.24 One investor maintained that his adviser group should not have recommended and then 'deceptively' implied that the investments were suitable for his financial situation'.[31] Another investor spoke of being coached through the questionnaire 'until my profile matched the requirements for the investment'. She stated further:

> I was completely naïve to why this was necessary. I did not realise that she was protecting herself by me being seen to be compliant.[32]

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27 Name withheld, *Submission 100*, p. 10; Mr Tyson O'Shannassy, *Submission 158*, p. 4; *Confidential Submission 35; Confidential Submission 36*, p. [4]; *Confidential Submission* 79; Confidential *Submission 115*, p. 2.

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

29 Roderick and Andigone Aguilar, *Submission 67*, p. 1; *Confidential Submission 92*, p. [1].

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

31 *Confidential Submission 35*, p. [2].

32 *Confidential Submission 81*.

7.25 Another adviser actively discouraged a woman from putting money into superannuation. According to her confidential submission, the adviser informed her that the problems with superannuation, among other things, was that it was 'locked away'; she could not access it if needed; she did not have enough money to make it viable and further 'there was no guarantee to whom it would be paid when she died'.[33]

7.26 The committee has noted that many of those who wrote to the committee were not financially well-off with little to no investment experience. But even those who were high income earners were entitled to receive sound professional advice from their financial adviser. One such high-income earner acknowledged that he received a tax benefit from his MIS investments but now had accumulated a significant debt arising from the MIS investments. He stated that his adviser only ever suggested investing in MIS and never promoted other investments. According to this investor, he now has virtually no superannuation, no diversification in his investment portfolio; a huge MIS debt; and is struggling to pay rates, school fees and tax.[34]

7.27 There are many cases where the investor clearly did not understand the agreements they were entering and the adviser appeared to do nothing to disabuse clients of false impressions. Indeed, evidence presented throughout this report so far strongly suggests that some financial advisers actively fostered misconceptions. Five glaring examples of the misunderstandings allowed to go uncorrected were that:

- the schemes were government endorsed by the ATO and ASIC;
- the investment was sound, safe and would return long term benefits;
- the investor was actually purchasing a piece of land as per the loan agreement;
- the investment funds would be used to plant trees or crops; and
- the loan used to finance the investment was affordable, self-funding and non recourse.[35]

Poor advice in the extreme

7.28 The FPA held very strong views on the standard of advice that was provided to retail investors in MIS by some financial advisers. Firstly, it questioned the quality of advice provided by a representative who is limited to recommending only one product, such as the numerous references to accountants who were an authorised representative of an MIS. Secondly, the advice ignored the fundamentals of good financial advice, in particular the importance of diversification—'Do not put all your eggs in the one basket'. The FPA noted:

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33 *Confidential Supplementary Submission 156.1*, pp. [1]–[2]. Ms Naomi Halpern provides another such example, who, by the end of 2008, found herself in substantial debt but with only $11,000 in superannuation. *Proof Committee Hansard*, 12 November 2014, p. 1.

34 *Confidential Submission 128*, p. 1.

35 See, for example, *Submission 56*, pp. [1]–[2].

> Those financial planners or accountants who recommended that their clients invest a majority or 100 per cent of their assets into a forestry management investment scheme, particularly using leverage, would not be considered appropriate.[36]

7.29 According to a FPA survey completed in 2009, FPA members who advised on forestry and agribusiness managed investment schemes, recommended that their clients limit the maximum on the whole in those investments to 'around 10 per cent, with some having rules that capped it as low as two per cent'.[37] Mr Neil Kendall, Chair FPA, explained that a five to 10 per cent exposure would give anyone in the situation of a product failure 90 per cent of their portfolio intact.[38]

7.30 Another important principle concerned the 'judicious use of debt'. Mr Mark Rantall, CEO FPA, explained that debt 'can be your friend, but it can be your foe':

> When you borrow and the assets that you borrow against disappear, or their value drops…you need to be in a position to service that debt. Clearly in these instances…there was inappropriate screening of people's ability to pay and inappropriate people were put into these products—and were also leveraged up inappropriately.[39]

7.31 In his view, a responsible financial planner would have recommended capping both the MIS and the debt at a 'relatively low level'.[40]

Committee view

7.32 The investors who made submissions to the inquiry received advice that defies some of the most basic and fundamental tenets of sound investing. The advice failed to promote portfolio diversification; played down the value of building and protecting a superannuation nest egg; mismatched the product to the investor's risk profile (recommending high risk products to low risk profiles); and placed the adviser's own interests ahead of those of clients. In some cases, potential investors were advised to divert funds intended for superannuation; not to invest in property; and to overcommit including borrowing up to 90 per cent through a full recourse loan in a speculative venture without considering that the project may fail to deliver as promised.[41]

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36 Mr Mark Rantall, *Proof Committee Hansard*, 6 August 2015, p. 24.

37 Mr Mark Rantall, *Proof Committee Hansard*, 6 August 2015, p. 24.

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

39 *Proof Committee Hansard*, 6 August 2015, p. 28.

40 *Proof Committee Hansard*, 6 August 2015, p. 28.

41 *Confidential Submission 79*, p. [1] and *Confidential Submission 130*, p. [1].

Commissions

7.33 During the period under the committee's consideration, investor protection required only that investors be fully informed of the fees and commissions that applied: that there was 'no prohibition against charging high commissions'. Even though the Corporations Act clearly stipulated that commissions must be disclosed, this area of corporate governance in 2001 still exhibited many transparency related concerns. ASIC told the committee in 2001 that out of 91 prospectus documents investigated by ASIC:

> …30% did not disclose the commissions payable or the percentage of commission payable.[42]

7.34 The matter of high fees and commissions, raises two areas of concern—the incentive for an adviser to recommend a product for personal reasons (better remuneration irrespective of the merits of a product); and the siphoning of funds away from the investment. In this chapter, the committee is concerned with the influence that commissions exerted over the quality of financial advice.

Early concerns about commissions as a perverse incentive

7.35 As early as 2001, ASIC had identified high up-front management fees and commissions as a major area of concern in agribusiness MIS.[43] Again in 2003, ASIC was aware of the payment of high commissions in excess of market norms for other retail investment schemes.[44] At that time, it undertook surveillance to determine whether there was a link between the receipt of high commissions by financial advisers and the provision of inappropriate or misleading advice to investors to buy into such schemes.[45] It found that:

> …there appears to be a correlation between primary production scheme promoters paying high commissions to advisers and those advisers providing inappropriate financial advice when they recommend those products to clients. In ASIC's view, this correlation indicates that there may be instances of a failure by advisers to manage conflicts of interest, where their personal interests in recommending a product supersede the client's need for good and appropriate advice.[46]

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42 Minority Report by Senator Shayne Murphy to the Senate Economics Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final report, February 2002, paragraph 1.125.

43 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.49.

44 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 4.

45 ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 4.

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

7.36 Commissions paid to advisers were generally around the 10 per cent figure.[47] Former Timbercorp officer, Mr Peterson, informed the committee that advisers who were writing a lot of business would seek higher commissions by implying that otherwise they would support another scheme. He described the situation as 'almost like a bidding war'.[48]

7.37 In 2008, the NFF also identified the potential for high commissions to provide undue incentive for planners to invest client dollars in such schemes.[49] Adviser Edge, an investment research house that specialised in agribusiness, raised concerns about MIS. In 2008, it suggested that adviser commissions were too high in both 'an absolute and relative sense'. In its view, 10 per cent commissions were among the highest in the financial planning industry, stating further that there were:

> …many financial advisers [who] do not have a strong knowledge of the agricultural sector, and hence there is a tendency for investment decisions to be based more heavily on the level of commissions, rather than the strength of the project.[50]

7.38 Adviser Edge submitted that closer regulation of the level of commissions and marketing fees to advisers would 'result in less bias towards investments paying high commissions'.[51]

7.39 Many investors, who wrote to the committee, referred to the commissions paid to advisers for selling MIS and were convinced that the practice was a factor underpinning poor advice. In the words of one couple, the promoters:

> …used smooth talking financial planners to sign up investors under the guise of giving a comprehensive, 'well thought out' financial plan and at the same time pocketing substantial commissions. These commissions were paid in advance despite many of the investments projected to be cashflow positive only after 10 years or so.[52]

7.40 Another indicated that:

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47 See for example, name withheld, *Submission 44*, p. 3; name withheld, *Submission 53*; Mr Bill Murrowood, *Submission 112*, p. 1; Grant and Karen Lillecrapp, *Submission 109*, p. [1].

48 *Proof Committee Hansard*, 12 November 2014, p. 27.

49 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014). The NFF indicated the MIS promoters were offering financial planners commissions of between 10 and 13 per cent.

50 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 13, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

51 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 13, http://archive.treasury.gov.au/documents/1423/PDF/Adviser_Edge.pdf (accessed 23 November 2014).

52 *Confidential Submission 36*, p. [7].

> We were easy targets for smooth-talking advisors whose greed is contemptible. Holt Norman misrepresented the facts about our investments and neglected to mention they were benefitting from muti-tiered commissions and trailing bonuses, as rewards for pushing these products.[53]

7.41 Looking back, many investors can now plainly see that the advice they received was compromised by fees associated with the product, which eclipsed their adviser's requirement to act in their best interests.[54] Mr David Huggins, a lawyer representing his client who had invested in an MIS, contended that the high level of commissions paid by these schemes distorted the advisory process. In his assessment, the scheme promotors had formed the view that it was:

> …necessary for high levels of commissions to be paid so as to induce advisers to provide advice about them—the issue being that it was apparent to advisers that there was a high level of risk associated with these products and they needed to receive substantial commission payments to, in effect, compensate them for the risk that their clients would suffer loss as a result of investing in these *schemes* and blame their adviser for this event.[55]

7.42 Another investor indicated:

> In hindsight I find that the advice provided by my accountant was biased based on his vested interest which outweighed his requirement to act in my best interests. (Due to the heavily incentivised fees associated with the product).[56]

7.43 Mr Tom Ellison, financial analyst, observed that a financial planner selling a managed investment product has a much greater incentive to get a 12 per cent commission, particularly when the success or otherwise of the product would not become known for a number of years. Moreover, the product could be sold every year—'it was not just a one-off'.[57] Based on years of experience in the financial services industry, Mr Jeff Morris advised that the level of commission alone for agribusiness MIS should have 'sounded a note of caution about their bona fides'. Furthermore, he reasoned you could gauge how bad it was by the level of commission payable:[58]

> …the commission was there precisely to seduce the judgement of these experts.[59]

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53 *Confidential Submission 37*, p. 2.

54 Mr David Lorimer, *Submission 55*; name withheld, *Submission 100*, p. 9; and name withheld, *Submission 78.*

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

56 Mr David Lorimer, *Submission 55*.

57 *Proof Committee Hansard*, 4 August 2015, pp. 21 and 24.

58 *Proof Committee Hansard*, 12 November 2014, pp. 42 and 43.

59 *Proof Committee Hansard*, 12 November 2014, p. 42.

7.44 AgriWealth similarly noted that most of the individual investors in MIS forestry projects who had suffered financial hardship were retail investors and were often persuaded by the financial advisers to invest in the schemes. It observed:

> The financial advisers often had a conflict of interest in providing advice to retail investors in so far as they received commissions, sales incentives, etc from the promoters of those schemes. Those incentives were not always disclosed to the retail investors in an open and honest manner.
>
> Where MIS products continue to be offered to retail investors there needs to be tightening of regulation around the actions of financial advisers, financial planners, etc. Full and frank disclosures must be made by advisers to retail investors.[60]

7.45 Mr Michael Bryant reminded the committee also about the soft dollar payments, now outlawed, that were also used to entice advisers to sell products—races, grand finals, expensive dinners.[61]

7.46 The MIS illustrated clearly how the payment of commissions as remuneration for advisors providing financial advice could compromise that advice.

Recent legislation

7.47 The concern about financial advisers receiving commissions for their services has been well aired over recent years and the reforms intended to remove this type of incentive payment have been implemented. The FOFA reforms recognised that product commissions:

> …may encourage advisers to sell products rather than give unbiased advice that is focused on serving the interests of the clients. Financial advisers have potentially competing objectives of maximising revenue from product sales and providing professional advice that serves the client's interests.[62]

7.48 As such, FOFA imposed a ban on the receipt of remuneration that could reasonably be expected to influence the financial product advice given to retail clients.

7.49 Based on evidence presented during this inquiry, some witnesses expressed concerns about any proposed relaxation or watering down of these reforms. Indeed, some identified the need for additional reforms. For example, Industry Super Australia (ISA) was concerned about any possible amendments to the legislation that would result in 'the re-emergence of practices such as conflicted remuneration which were central to the mis-selling of forestry MIS such as Timbercorp'.[63]

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60 *Submission 138*, p. 2.

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

62 Replacement Explanatory Memorandum, Corporations Amendment (Further of Financial Advice Measures) Bill 2011, paragraphs 2.3 and 3.27.

63 *Submission 136*, p. 3.

Committee view

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

Recommendation 2

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

Holding financial advisers to account

7.52 Advisers were not at fault in accepting high commissions. They were, however, in breach of the Corporations law by not disclosing such information. Licensed financial advisers were required to disclose to their clients all commissions attached to the sale of particular financial products and hence any possible conflicts of interests.[64] A number of submitters maintained that their adviser did not disclose the substantial commission they were receiving, including trailing commissions.[65] For example, Mr Peter Mazzucato did not know that his adviser had obtained secret commissions to promote the Timbercorp investment scheme.[66] Likewise, Ray and Maree Wilde were certain that no mention had been made of the 10 per cent commission their adviser would receive. They noted that the Timbercorp documents refer to five per cent.[67]

7.53 This tendency to gloss over or to fail to disclose commission is consistent with the pattern of poor behaviour of some financial advisers that included, as chronicled in this report, downplaying risks, failing to disclose material facts about loan arrangements, allowing the perception to take hold that the products were government endorsed, high pressure selling, overly optimistic projections about the products performance, and ignoring the client's risk profile. The matter of holding financial advisers to account for providing unsound advice is covered in greater detail in the following chapter.

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64 Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.39.

65 Name withheld, *Submission 45*, p. [1]; name withheld, *Submission 62*; *Submission 89*, p. [1]; name withheld, *Submission 94*, p. [2]; Mr Bill Murrowood, *Submission 112*; name withheld, *Submission 121*; *Confidential Submission 36*, p. [3]; *Confidential Submission 39*, p. 2; *Confidential Submissions 81*, 130, p. [1]; and *Confidential Submission 140*, p. 2.

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

67 *Submission 43*, p. 2.

Role of accountants

7.54 A number of people providing advice on MIS were accountants. For example, during the Great Southern proceedings, the court was told:

> Most, if not all, investors in Great Southern projects sought advice from an external accountant and/or a financial planner prior to investing. However, not all accountants held their own AFSL and often did not want to because of the additional compliance costs. By appointing external accountants as Authorised Representatives of GSS [Great Southern], these accountants were able to act under GSS's AFSL and were able to provide their clients with financial product advice without having to obtain their own AFSL.[68]

7.55 Accountants occupy a privileged position, especially with long-term clients, where often they have established a good relationship and have insight into their client's financial affairs. In this regard, one investor captured the sentiments of a great many of the investors who wrote to the committee when she stated:

> My then accountant was my trusted adviser at the time, having been my accountant for some years, and I regularly took his advice on business and taxation issues as I was involved in a family business.[69]

7.56 One submitter, however, drew attention to the blurring of responsibilities between the roles of an accountant and a financial adviser providing financial advice.[70] For example, a lawyer acting on his client's account alerted the committee to his concerns about the conduct of an accountant. For a number of years, his client had been using the services of an accounting firm. An employee of that firm had been appointed as an authorised representative of Rewards Projects Limited, which held an AFSL and was the RE for the Rewards Group Premium Timber Project 2009. According to the lawyer, it appeared that the employee used knowledge of his client's financial affairs—information gained as a result of acting as the client's accountant—and access to his client, in terms of providing advice about taxation related issues, as a means of marketing the investment to him. The pertinent issue being that the alleged tax effective nature of the investment was the primary means by which it and similar investments were marketed to clients. Relevantly, the lawyer noted that:

> …issues concerning the quality of financial advice are usually thought of in terms of advice provided by financial planners. However, in my experience, accountants had a substantial involvement in the marketing of agricultural managed investment schemes to clients. In this regard, I assume that the promoters of these schemes viewed accountants as being a useful distribution channel for their products because their alleged *tax effective*

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

69 Name withheld, *Submissions 151*, p. 2. See also name withheld, *Submission 152*, p. 1 and Mr Shaun Ritchie, *Submission 159*, p. [1].

70 Name withheld, *Submission 41*, p. 3 and Mr Tyson O'Shannassy, *Submission, 158*, p. 3.

> nature would be relevant to issues that accountants were already discussing with their clients.[71]

7.57 In the lawyer's view, the practice of accountants providing advice about MIS was 'generally improper', as 'accountants' knowledge of their clients' taxation affairs was used as a means to market *tax effective* investments to clients'.[72] Furthermore, the accountants were often authorised to provide advice by the scheme's promoter. In his opinion:

> …a real issue arises as to whether it is appropriate that a person can, in effect, be authorised by the promoter of a scheme to solely provide advice about that scheme (the issue being that the accountant is acting as little more than a *salesman* for a particular financial product rather than as a financial advisor). More generally (as was the case here), these types of arrangements can leave clients with limited options should they receive poor financial advice—the issue being that if the promoter fails the client will not be able to pursue the promoter by way of an external dispute resolution scheme such as the Financial Ombudsman Service (in these circumstances, the only remedy likely to be left to the client is to commence proceedings in a Court against the accountant which can be problematic for a number of reasons).[73]

7.58 Clearly, accountants were in a position to use knowledge of their client's financial affairs to offer unsolicited advice. For example, one investor informed the committee that the MIS investment was brought to his attention and recommended to him during an unrelated appointment for business taxation advice.[74] Another couple said that their adviser was t heir trusted accountant who had been looking after their business affairs for many years. They stated that they now know that their accountant was not giving advice but selling products from which he profited and were clearly unsuited for their financial situation.[75]

7.59 One investor spoke of his financial adviser's 'grossly conflicted role' as a Great Southern representative. He argued that the adviser's 'inside knowledge' of his affairs enabled the adviser, based on the tax returns he had provided, to present the investor to Great Southern Finance as credit-worthy.[76]

7.60 A number of investors named certain advisers who had recommended investing in a particular MIS. During the course of the inquiry, the committee provided ASIC with the names of those advisers. According to ASIC, although

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71 *Submission 118*, p. 2 (emphasis in original).

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

73 *Submission 118*, p. 6.

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

75 *Confidential Submission 156*, p. [5].

76 Name withheld, *Submission 44*, p. 3.

referred to as advisers, one business, an accounting firm, did not hold an AFS licence nor was it a corporate authorised representative. Two were authorised representatives of a few MIS but recorded as investors rather than advisers and another was an authorised representative of Timbercorp Securities Ltd and Rewards Projects Limited. ASIC's understanding was that:

> …all of the Timbercorp Securities Limited authorised representatives were qualified accountants and only authorised to provide general advice to investors.[77]

7.61 But, according to the investors, these individuals or accountants did provide personal advice and facilitated the investment into the MIS.

7.62 Concerned about the possible lack of a robust regulatory regime governing accountants giving financial advice, especially an accountant who was an authorised representative of an agribusiness MIS, the committee put specific questions to the Treasury, ATO and ASIC. Their responses clearly spelt out the obligations on accountants or tax agents providing financial advice.

7.63 It should be noted that since the introduction of the FOFA reforms, financial advisers and accountants providing personal advice must act in their client's best interest and prioritise the client's interest over their own. According to ASIC:

> These new requirements should reduce any possible conflicts of interests in circumstances where accountants have information about a client's tax position and are providing financial product advice. This is because the adviser must put the client's interests ahead of their own.[78]

7.64 The Tax Practitioners Board (TPB), which is responsible for regulating tax agent services, is aware that some tax agent services are provided in the context of the provision of financial advice. It informed the committee that any person/entity providing such advice for a fee or reward needs to be registered with the TPB as a tax agent or tax (financial) adviser. According to the TPB, all tax practitioners who are registered with the TPB must comply with obligations under the *Tax Agent Services Act 2009* (TASA), which among other things, includes a legislated Code of Professional Conduct. Under this code a tax practitioner must act lawfully in the best interests of their client.[79] TASA commenced on 1 March 2010.

7.65 Despite recent reforms, and in light of the numerous references to tax agents providing advice on agribusiness MIS and on borrowing to invest in such schemes, the committee has lingering concerns about the regulatory regime covering accountants/tax agents providing this advice.

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77 ASIC, confidential answer to written question on notice, No. 19, 2 October 2015.

78 ASIC, answer to written question on notice, No. 8, 2 October 2015.

79 Treasury, answer to written question on notice, No. 10, 8 October 2015.

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

Recommendation 3

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

Conclusion

7.68 The committee has established that some advisers failed comprehensively in adhering to the requirements to know their client and the product they were recommending, and to have a reasonable basis for their advice. Evidence indicates that, in numerous cases, advisers and accountants withheld important information, particularly about the high risks involved; wilfully downplayed risks; and exaggerated the returns on investment. They put their own interests above those of their clients in giving poor advice, which resulted in their clients sustaining substantial financial losses. Such advisers seemed more intent on selling a product because of the attractive commissions they could earn rather than providing their client with appropriate advice.

7.69 The committee has referred to recent reforms, such as banning conflicted remuneration, that should help to lift the quality of financial advice. In the following chapter, the committee considers other consumer protection measures including the educational standards and qualifications of financial advisers and the overall culture in the financial advice industry.