Chapter 9

Product developers and promoters

> I feel embarrassed and ashamed at having put my hard earned money into products so unreliable and totally unsuitable for my circumstances that have delivered zero returns and cost me money. I have, and still continue to suffer stress and sleeplessness.[1]

9.1 Financial advisers had a prominent role in marketing and selling MIS but they were not the only agents. They relied on promotional material provided by the product manufacturers and were often part of a larger public relations campaign to attract investors into the schemes. While there can be no doubt that in many instances advisers may have misled their clients, sometimes inadvertently, sometimes deliberately, they themselves may not have understood or appreciated the pitfalls of the product they were recommending. Even though financial advisers should have known better, some of them fell under the spell of the promotional material produced by the product manufacturer and issuer.

9.2 Therefore, it should be recognised that there are various other parties in the industry that should also be held accountable for the promotion and marketing of financial products. The FPA drew attention to this fact in its submission to the committee's 2014 inquiry into the performance of ASIC:

> It is well established that, rather than all fault lying with the advice provider, there are multiple participants who offer products or services within the financial advice value chain, all of whom influence, directly or indirectly, consumers' decisions on financial matters. However, accountability of these participants to the end consumer is variable, limited and for some practically non-existent, which significantly restricts ASIC's ability to act…[2]

9.3 Thus, all stakeholders involved in selling agribusiness MIS contributed in some way to influencing a consumer's decision to invest in the product.[3] Indeed, the FPA attributed the large-scale losses associated with agribusiness MIS to 'inadequate leadership' and 'the non-existence of accountability' of those responsible for developing, providing research on, and marketing the schemes.[4]

9.4 In this chapter, the committee considers the disclosure obligations imposed on the producers and promoters of MIS and the extent to which they kept investors informed of their respective MIS. It looks not only at the comprehensiveness and

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1 Name withheld, *Submission 184*, p. 4.

2 *Submission 161*, p. 4.

3 *Submission 161*, p. 4.

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

comprehensibility of the disclosure documents but also of the conduct of the promoter and adviser when offering these products to the market. The committee also considers whether investors were appropriately and promptly informed of significant developments in the performance of the scheme.

Informed decision-making

9.5 As observed throughout this report, most of the growers who wrote to the committee described themselves as inexperienced and definitely not sophisticated investors. They claimed that they understood little about the complexities of MIS. For example, the common thread that seems to run through the experiences of many of the investors was that they were not 'savvy' business people but mostly 'working class people…trying to do their best to provide for our families'.[5]

Information asymmetry

9.6 Information asymmetries are a major factor that can prevent the market operating efficiently and have the potential to put retail investors at a disadvantage. Asymmetric information is when one party to a transaction has an inherently greater knowledge of the quality and risk profile of a product than the other side.[6] Those in possession of knowledge not available to the investor are able to use this imbalance for their own benefit. The information advantage, according to ASIC, 'gives opportunities to institutions and intermediaries to profit at the expense of investors and financial consumers'.[7] In this regard, the financial services' disclosure regime includes rules designed to:

- overcome the information asymmetry between industry participants and investors by requiring disclosure of information required to facilitate informed decisions by investors; and
- promote transparency in financial markets, and the efficient and appropriate pricing of assets and risks—for example, through continuous disclosure by companies of price-sensitive information.[8]

9.7 Product providers, distributors, advisers, and other gatekeepers of agribusiness MIS must then bear some responsibility for ensuring that consumers buying their product are fully informed about the risks associated with investing and borrowing to invest in their schemes.

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5 *Submission 68*, p. [3]. See chapter 6 for a thorough account of retail investors and their experience with MIS type schemes.

6 See, for example, Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 19.

7 *Submission 34*, paragraph 27.

8 *Submission 34*, paragraph 32.

Long standing concerns about disclosure

9.8 Long before the collapse of the major agribusiness MIS, some people in the industry were concerned that the risks associated with the schemes were not sufficiently disclosed. As early as 1993, the Law Reform Commission and the Companies and Securities Advisory Committee were issuing clear and unambiguous messages highlighting the importance of investors being well informed about the schemes in which they were intending to invest.[9] In particular, they noted that the regulatory framework for managed investment schemes had long recognised that:

> …the law can and should ensure that investors are given all the information they need to understand fully, and to judge for themselves, the level of investment risk associated with any scheme so they can choose, with full knowledge, the scheme that best suits their investment objectives.[10]

9.9 At that time, however, the Law Reform Commission and the Companies and Securities Advisory Committee, with great prescience, issued the following warning:

> As collective investment schemes, and the way in which they are marketed, become more complicated, it is more likely that schemes will be marketed to individuals who lack the financial sophistication to assess the risks involved in investing in them.[11]

9.10 They conceded that the law could not ensure that all intending investors would understand the nature of the scheme. They argued, however, that the law can, and should, impose rules to ensure that:

- the operator of the scheme gives investors all the information relevant to the assessment of risk that the operator has available to it; and
- information is presented in a clear and comprehensible way and is not misleading.[12]

Prospectuses and product disclosure statements

9.11 An MIS is deemed to be a financial product and hence various disclosure requirements regulate the process of giving personal advice recommending this

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9 The Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol 1, 1993, p. 9.

10 The Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol 1, 1993, p. 9.

11 The Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol 1, 1993, p. 10.

12 The Law Reform Commission, and the Companies and Securities Advisory Committee, Report *Collective Investments: Other People's Money*, ALRC Report No. 65, Vol. 1, 1993, pp. 10–11.

product and offering or arranging its issue.[13] There are a number of key documents that form the basis of information that investors need in order to make informed decisions. The prospectus and product disclosure statement (PDS) are of central importance and legislation sets down the information they must contain.

Prospectuses

9.12 The function of a prospectus is to provide potential investors and advisers with sufficient information regarding the company's financial position and the nature of the security on offer so they can make an informed investment decision.[14] It should explain the merits and risks involved in participating in the scheme. This document must be prepared by, or on behalf of, the issuer or seller of a financial product. ASIC's Regulatory Guide made clear that the law requires an issuer to ensure that information contained in its prospectus is 'always current during the application period and to lodge a supplementary or replacement prospectus if it is not'.[15]

9.13 The product disclosure statement replaced the prospectus from March 2002 as a required instrument of disclosure for MIS.[16]

Product Disclosure Statement

9.14 In order to offer an agribusiness MIS to the market, the RE must publish a PDS. The PDS is designed to help consumers compare and make informed choices about financial products. When a financial adviser provides financial advice to a client that contains a recommendation to invest in an MIS, the adviser must give the client a PDS for that scheme.[17] Under these requirements, the adviser must do so at or before the time the adviser provides the advice; the information contained in a PDS must be up-to date at the time it is given and worded and presented in 'a clear, concise and effective manner'.[18]

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13 The definition of financial product includes an interest in a registered scheme; a legal or equitable right or interest in such an interest or an option to acquire, by way of issue, an interest or legal or equitable right as mentioned. For the more specific and detailed conditions governing disclosure see Chapter 7, Part 7.9, Division 2 of the *Corporations Act 2001*.

14 ASIC, Regulatory Guide 56, *Prospectuses*, (updated February 2000), RG 56, paragraph RG 125.

15 ASIC, Regulatory Guide 56, *Prospectuses*, (updated February 2000), RG 56, paragraph RG 56.18.

16 ASIC, answer to question on notice, No. 3, 2 October 2015.

17 *Corporations Act 2001*, s 1012A. Sections 1012A, 1012B and 1012C of the act establish the obligation to give a Product Disclosure Statement (PDS) when personal advice is given recommending a particular financial product; when an issue of, or an offer to issue, a financial product is made; or when an offer to sell a financial product is made.

18 *Corporations Act 2001*, ss 1012J and 1013C.

9.15 The Corporations Act recognises the matters that a PDS should take into account.[19] Section 1013D of the Corporations Act sets out the main requirements governing a PDS which, among other things, specifies that the PDS include the following information: any significant benefits to which a holder of the product will or may become entitled; any significant risks associated with holding the product and costs; amounts payable by a holder of the product after its acquisition; and the times at which those amounts will be payable. The PDS must include information about any other significant characteristics or features of the product or the rights, terms, conditions and obligations attaching to the product. In other words, it is required to contain any other information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product.[20]

9.16 ASIC explained that, with an unlisted product such as an agribusiness MIS, the product issuer, under the law, must lodge an 'in use' notice, which informs ASIC and others including investors that a PDS is in use and where they can obtain a copy of it.[21] Importantly, ASIC does not receive a copy of the PDS: it is not lodged with ASIC and ASIC does not approve a PDS' contents or 'stand behind the investment-worthiness of particular PDS' statements'.[22]

Disclosure of commissions and fees

9.17 Consistent with the requirement to disclose whether the product will or may generate a return to a holder of the product, the PDS must contain information about any commission, or other similar payments, that will or may affect the amount of such a return.[23] In 2003, ASIC provided the following guidance on fee disclosure in the PDS:

> Where the purpose of a fee includes the remuneration of advisers, this should also be indicated in the fee description.[24]

9.18 At that time, there was general recognition in the industry of the need for improved disclosure of adviser remuneration with ASIC advising that it was 'important in a good practice model to clearly disclose whether a particular fee includes commission'.[25] Also, ASIC was of the view that commissions and

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19 *Corporations Act 2001*, s 1013F.

20 *Corporations Act 2001*, ss 1013D and 1013E.

21 Mr Paul Eastment, *Proof Committee Hansard*, 14 October 2015, pp. 24–25.

22 Mr Greg Tanzer, *Proof Committee Hansard*, 14 October 2015, p. 24. Also see discussion in chapter 4 on ASIC and prospectus, paragraphs 4.38–4.43.

23 *Corporations Act 2001*, para 1013D(1)(e).

24 ASIC, Report 23, *A model for fee disclosure in product disclosure statements for investment products*, July 2003, paragraph 5.11.

25 ASIC, Report 23, *A model for fee disclosure in product disclosure statements for investment products*, July 2003, paragraph 3.9.

information on soft dollar arrangements needed to be spelt out clearly in the PDS. It advised that:

> …improved disclosure of adviser remuneration at all stages of the investment decision-making process (including the PDS) is an important consumer issue.[26]

9.19 The committee has already noted the high commissions advisers received for selling MIS. Some submitters suggested, however, that the commissions paid to advisers were not always fully disclosed.[27] Based on their recollection, they were unaware their financial planner was 'getting a substantial benefit in addition to the initial fee' with a reference to secret commissions being paid.[28] Evidence also indicated that the PDS failed to disclose to growers other material information about their investment in MIS.[29]

Misunderstandings

9.20 As highlighted in 1993, the law should ensure that investors are presented with all the information, in a clear and comprehensible way, required to make an informed decision. But, as noted throughout this report, many investors were confused, or simply misinformed, about important features of their scheme. For example, some investors were allowed, or even encouraged, to assume that the schemes were government backed—ATO and ASIC endorsed. The catalogue of misunderstandings about the nature or operation of MIS' investments included, in some cases, the requirement to pay up-front and ongoing maintenance fees. In particular, investors were under the false impression that their loans were structured in such a way that they were almost self-funding; that there was little risk of default with long term returns a certainty and liability limited to the actual investment (home not at risk). Few understood the implications of signing over power of attorney. Overall, many of the growers who made submissions to this inquiry thought the schemes were fail-safe: that they were unaware of the risks involved in the MIS. Some argued strongly that the PDS was misleading and had the document spelt out such risks, they would not have invested. In this regard, an investor stated that there was never any discussion of the risks, no PDSs provided until after the client had signed and all documentation was mailed.[30]

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26 ASIC, Report 23, *A model for fee disclosure in product disclosure statements for investment products*, July 2003, paragraphs 5.11 and 5.16.

27 See, for example, AgriWealth, *Submission 138*, p. 2.

28 See, for example, Mr Peter Mazzucato, *Submission 40*, p. [2].

29 Mr. Stefan Kaiser, *Submission 107*, p. 4.

30 Name withheld, *Submission 162.*

Ownership of tangible asset

9.21 Confusion about the structure and operation of the MIS went beyond the matters already identified in this report with grower after grower recalling their bewilderment at many aspects of the schemes' operation. For example, many were under the impression that their funds would go directly to their particular allotment. They thought that they would own a tangible asset—the trees or the actual harvest. One couple thought they were actually purchasing 'a piece of land as per the loan agreement…'[31] ASIC on the other hand explained that:

> …grower application money is (in most cases) diverted into the general working capital of the parent entity. The parent entity manages this money to meet expenses associated with all of its operations, including maintaining, cultivating and harvesting each scheme.[32]

9.22 Mr Tom Ellison, financial analyst specialising in Tasmanian listed companies, who bought two Gunns wood lots, stated that at one stage he did have a map but was yet to meet someone 'who actually invested in a scheme and who got to go and look at their own trees'. He noted:

> I know that, until 2006, Gunns and FEA [Forest Enterprises Australia] would pop people on a bus and take them up to the north-west and show them around, but I do not think it was a case of, 'Here are your trees.'[33]

9.23 Investors who came late to the schemes, felt particularly aggrieved about the apparent suddenness of the collapse which meant that their trees or crops were never planted. One woman explained that only a few months after investing, Timbercorp went into liquidation. It was inconceivable to her that she should have to repay with interest nearly $80,000 for something she had entered into just before its collapse—it did not seem 'fair or just'.[34]

9.24 The question of property rights became especially contentious during the liquidation of failed MIS. In its consideration of the establishment and operation of MIS, CAMAC observed that scheme members who have rights as lessees of property 'may have an expectation that their interests in the scheme are property interests that should have a favoured position in the winding up of a scheme'. It explained, particularly in reference to agricultural schemes:

> That expectation is not met under the present law where the lease can be disclaimed by a liquidator of the RE. To avoid disclaimer, member lessees

31 Name withheld, *Submission 56*, p. [2].

32 *Submission 34*, paragraph 52.

33 *Proof Committee Hansard*, 4 August 2015, p. 23.

34 Name withheld, *Submission 73*.

> would need to show that the prejudice to them is grossly out of proportion to the prejudice to the RE's creditors generally.[35]

9.25 CAMAC indicated that if the law remained unchanged, a question arises whether those who intend to become lessee investors should have the benefit of disclosure of the possible consequences of a liquidation of the scheme as it relates to the interests they intend to acquire in the scheme.[36] This confusing area of rights of investors, farmers who leased property to the RE and creditors is dealt with in chapter 15.

Projections and forecasts

9.26 The likely yield, which is a critically important consideration for any investor, was another aspect where growers failed to appreciate fully the information provided in disclosure documents. According to two researchers:

> The Product Disclosure Statements for plantation forestry do not give financial projections because ASIC policy strongly discourages them from doing so. However, they do give projections of physical yield, usually through the medium of an independent forester's report.[37]

9.27 During the early 2000s, however, some in the agribusiness industry were troubled by the yield projections in disclosure documents. They expressed concern that many agribusinesses were making 'excessively optimistic, if not misleading, projections of future product yields and marketability in their prospectuses'.[38] For example, in 2004, a number of submitters to the Senate Rural and Regional Affairs and Transport References Committee gave evidence indicating that the price estimates for future cropped plantation timber were either impossible to forecast or incorrect. One such witness put to the committee that 'forecasts contained in at least one prospectus for plantation investment indicated that realisable prices for wood were higher than the market was returning'.[39]

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35 Corporations and Markets Advisory Committee, *The establishment and operation of managed investment schemes*, Discussion paper, March 2014, p. 189.

36 Corporations and Markets Advisory Committee, *The establishment and operation of managed investment schemes*, Discussion paper, March 2014, p. 190.

37 Patrick Mackarness and B Malcolm, 'Public policy and managed investment schemes for hardwood plantations', School of Agriculture and Food Systems, The University of Melbourne, *Extension Farming Systems Journal*, volume 2, number 1, p. 105.

38 See, for example, Senate Economics References Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final report, February 2002, paragraph 4.64.

39 Senate, Rural and Regional Affairs and Transport References Committee, *Australian forest plantations: A review of Plantations for Australia: The 2020 Vision*, September 2004, paragraphs 3.81–3.83.

9.28 Doubts about predicted yields of MIS projects did not abate especially as early plantations came 'on stream'.[40] Some submissions to the 2005/06 Plantation Forestry Taxation Review were concerned about the accuracy of the material which appeared in MIS prospectuses and cited 'some very ambitious yield forecasts'.[41] Around the same time, a study by the Rural Industries Research and Development Corporation also noted the poor quality of information available to investors. It observed:

> Arguably, the understandable attempts by ASIC to deal with the serious information problems of MIS have not been successful.[42]

9.29 In evidence to the committee, Mr Samuel Paton, principal of an agricultural consulting valuation firm, recalled that a PDS for a start-up MIS just out of Ballarat being developed by Environinvest stated that the scheme was going to produce 270 to 300 cubic metres per hectare of *E. globulus* from the site. Together with a forester, Mr Paton inspected the site, which, in his words, did not look 'too promising'. Further, Mr Paton informed the committee that based on the calculations of rainfall and soil structure, among other variables, the forester came up with a projected yield of 116 cubic metres per hectare. According to Mr Paton, '49 million dollars later, Environinvest went broke'.[43]

9.30 In the lead-up to the collapse of some MIS, concerns were still being voiced about a number of aspects of the schemes, including the information available to investors on performance. For example, in its 2008 submission to the non-forestry MIS review, the NFF raised significant doubts about the adequacy and independence of information available to potential investors in agricultural MIS.[44] In its view, an appropriate level of market accountability by promoters and managers of MIS projects had been lacking. While the NFF recognised that some MIS already provided detail on the long-term financial performance of the schemes, it formed the view that the

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40 Judith Ajani, 'Climate change policy distortions in the wood and food market', The Australian National University, Contributed paper to the Australian Agricultural and Resource Economics Society National Conference 2010, 8–12 February, p. 15, in *Submission 26*.

41 See, for example, submissions to the Review of taxation treatment of plantation forestry from Sam Paton & Associates Pty Ltd, http://archive.treasury.gov.au/documents/1000/PDF/042_Paton.PDF (accessed 1 May 2015) and Evan D. Shield, http://archive.treasury.gov.au/documents/1000/PDF/002_Evan_Shield_1&2.pdf (accessed 1 May 2015).

42 Rick Lacey, Alistair Watson and John Crase, *Economic effects of income-tax law on investments in Australian agriculture with particular reference to new and emerging industries*, Rural Industries Research and Development Corporation, RIRDC Publication No 05/078, RIRDC Project No AWT–1A, January 2006, p. 48.

43 *Proof Committee Hansard*, 4 August 2015, pp. 1 and 4.

44 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 4, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014).

current system could not be relied on to deliver accurate and independent information commercially evaluated by industry experts.[45] The Victorian Farmers Federation was similarly concerned about that the lack of transparency surrounding MIS, which made it difficult to determine whether schemes were commercially viable and structured towards long-term sustainability.[46]

9.31 In 2008, Dr Judith Ajani observed that while planting continued apace, prospectus expectations of market opportunities for woodchips had not yet materialised.[47] ASIC noted in 2009 that a number of past projects operated by participants in the agribusiness managed investment scheme industry had failed to achieve their expected returns. It was of the view that:

> This information may be relevant to assist retail investors to decide whether or not they are prepared to invest in an agribusiness scheme. Accordingly, disclosure of historic yield information might reasonably be expected to have a material effect on the decision of a reasonable person to invest in an agribusiness scheme and required under the Corporations Act to be disclosed in PDSs. However, it appears that this information has not been disclosed in some agribusiness managed investment scheme PDSs.[48]

9.32 Evidence before the committee noted similar concerns about the reliability of projected yields. The Department of Agriculture referred to doubts being raised about the accuracy of the growth rate and yield forecasts contained in some forestry MIS.[49] Mr Peterson, a former Timbercorp officer, explained to the committee:

> …the most disappointing thing about Timbercorp is that it did not disclose to the growers, including senior management…exactly what would be the costs on horticulture, produce and timber lots if yields were not met and what was happening behind the scenes.[50]

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45 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. 4, http://archive.treasury.gov.au/documents/1423/PDF/National_Farmers_Federation.PDF (accessed 23 November 2014).

46 Submission to the Review of Non-Forestry Managed Investment Schemes, 12 September 2008, p. [1], http://archive.treasury.gov.au/documents/1423/PDF/Victorian_Farmers.pdf (accessed 23 November 2014).

47 Judith Ajani, *Managed investment schemes, tax deductibility and future plantation wood supply, Australia's Transition from Native Forests to Plantations: The Implications for Woodchips, Pulp mills, Tax Breaks and Climate Change*, ANU Press, nd (2008), http://press.anu.edu.au/agenda/015/03/mobile_devices/ch02s10.html (accessed 24 November 2014).

48 ASIC, *Submission 58* to the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia, August 2009, paragraph 209.

49 *Submission 135*, p. 8.

50 *Proof Committee Hansard*, 12 November 2014, p. 21.

9.33 He stated further that had Timbercorp been more honest about how the projects were performing, then certainly he and the many investors who lost badly would not have invested so heavily in the projects.[51] According to Mr Peterson, Timbercorp was very good at not disclosing full information to clients:

> In all the horticulture projects, you looked at a cash load to see whether you would go into it to see whether you would basically be able to meet your ongoing payments. What they did not do on an annual basis was give you an adjusted cash flow for your previous investment because if the growers saw that they would have been up in arms, saying: 'Hang on a minute! These yields are down, these costs are up; I'm never going to get into a positive cash flow position here.[52]

9.34 Mr Michael Hirst, Tasmanian farmer, similarly referred to numbers quoted in prospectuses, describing them as 'pure fudging of the figures'. With regard to tonnage, he told the committee that generally the yield was 'half of what they were quoting'.[53]

9.35 Importantly, a number of growers have taken their concerns about alleged defective PDSs to the courts. They maintained that the documents were deficient and because of this deficiency the arrangements they entered into should be nullified. While there is compelling evidence that information contained in PDSs on projected yields was optimistic, with some suggesting that it was misleading, the courts have, however, taken a different view. Two cases in particular are instructive—the first case dealt more broadly with claims of misleading PDSs, the second was concerned with the yields.

Court decisions

9.36 In 2011, in a case before the Supreme Court of Victoria, the plaintiff argued that Timbercorp Securities, in breach of its disclosure obligations under the Corporations Act, failed to disclose in its PDSs information about 'significant risks, or risks that might have had a material influence on the decision to invest'. In essence, the investors argued that the PDSs given to them contained false or misleading statements.[54]

9.37 In his judgment of September 2011, Justice Judd summarised the case pleaded by the growers who had invested in Timbercorp schemes. They claimed that:

- the RE, Timbercorp Securities, had failed to disclose information about risks it was required to disclose in compliance with its statutory obligations; and
- the Group business model involved risks associated with its financial structure that should have been disclosed to existing and potential scheme investors

51 *Proof Committee Hansard*, 12 November 2014, p. 22.

52 *Proof Committee Hansard*, 12 November 2014, p. 18.

53 *Proof Committee Hansard*, 5 August 2015, p. 15.

54 Woodcroft-Brown v Timbercorp Securities Ltd [2013] VSCA 284 (10 October 2013) [6]

because the risks were significant or may have had a material influence on a decision to invest in a scheme.[55]

9.38 The plaintiff argued that he would not have invested in the schemes and would not have borrowed from Timbercorp Finance to do so if he had been informed of:

- the structural risk—that the Timbercorp Group might fail because of insufficient cash; or
- any of the adverse matters—ATO's proposal to change its position on the deductibility of up-front fees paid by investors; and the tightening of global credit markets.

9.39 The investor was seeking declaratory relief, damages and/or compensatory orders, including an order that he and the group members were not liable for repayment of the loans from Timbercorp Finance.

9.40 The court, however, was not persuaded and found, among other things, that the Timbercorp Group was not required to disclose the risks identified by the growers; that there had been no misleading or deceptive conduct; and, in any case, there had been no relevant reliance by the investor on the alleged non-disclosure or representations.[56]

9.41 This decision adversely affected former members of the schemes, who hoped to be released from obligations under loan agreements they had reached with Timbercorp.

9.42 In October 2013, the Court of Appeal of the Victorian Supreme Court handed down a decision confirming Justice Judd's 2011 decision that denied damages to investors in the failed Timbercorp schemes. It also declined to grant investors relief from having to pay any further instalments on loans that had been arranged through Timbercorp and used to pay for the investments.[57]

9.43 The second case, the Great Southern (GS) proceedings, also centred on alleged deficiencies in the PDS. The plaintiffs argued that GS had issued PDSs relating to the offer of interests in its MIS that were 'defective' by reason of the provisions contained in Part 7.9 of the Corporations Act, which deals with financial product disclosure, and as a result suffered loss and damage.[58] This misrepresentation

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55 Woodcroft-Brown v Timbercorp Securities Limited (in liq) [2011] VSC 427 (1 September 2011) [24]–[26].

56 Woodcroft-Brown v Timbercorp Securities Limited (in liq) [2011] VSC 427 (1 September 2011).

57 Woodcroft-Brown v Timbercorp Securities Limited (in liq) [2011] VSCA 284 (10 October 2013).

58 Clarke v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (11 December 2014) [6].

case—the 2005 and 2006 Plantation Group Proceeding—concerned the target yield capability of 250m^3 of timber per hectare of woodlots referred to in the PDS issued on 8 March 2005.

9.44 In response to the plaintiffs' argument, the defendants contended that, when regard is had to the contents of the PDS, the misrepresentation case advanced in proceedings must fail: that the PDS, 'on its face, plainly does not represent what the plaintiffs plead that it represents'.[59]

9.45 Turning to the contents of the PDS, the court found:

> …its contents demonstrate that GSMAL [Great Southern Managers Australia Limited] did not promise, either expressly or by implication, that the plantations would produce an average of 250m^3 gross of timber per hectare of woodlots after approximately ten years of growth. On the contrary, the PDS contained many statements to the clear effect that the investment in the 2005 and 2006 Plantation Schemes was speculative, and that GSMAL and the directors did not make any forecasts or predictions as to future yields. Those statements are completely inconsistent with the implied promissory statement that the plaintiffs allege in paragraph 35(a).[60]

9.46 In essence, the court concluded that none of the PDS subject to the proceedings was 'defective'.

9.47 Bendigo and Adelaide Bank was also of the view that the relevant PDS were not flawed, pointing out that:

> Each PDS made it abundantly clear to investors that participation in the projects was considered to be speculative and prospective. Investments were of a medium- to long-term nature. The risks associated with plantation forestry were similar to any farming or agricultural venture. Investors were advised to read the PDS in its entirety and seek professional advice to ensure that an investment of that type was appropriate for their particular circumstances. The risks and speculative nature of the participation in the project were repeated many times throughout each PDS.[61]

9.48 In this context, the committee concludes that the disclosure requirements of the PDS cannot be considered in isolation. Retail investors make decisions in a complex environment where information and impressions are gleaned from numerous sources. The PDS is but one and, indeed, may not be the determining influence. For

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59 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [13] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

60 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [18] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

61 Bendigo and Adelaide Bank, response to *Submissions 52* et al, dated 24 December 2014, p. [4 and 5].

example, retail investors were expected to understand the significance of projected yields. In 2010, researchers referred to the practice of providing projections of yields and prices, rather than cash flow projections, in the disclosure documents to retail investors. They explained, however, that:

> Projections of yield, harvest costs, and harvest (produce) value, independently are based on a myriad of complex factors each of which is exacerbated by the long investment horizon.[62]

9.49 Consistent with generally accepted views, they argued that retail investors have limited ability to unravel the risks in such forecasts.[63]

Reconciling courts decisions with evidence

9.50 The committee has examined the testimony of growers in great detail trying to gauge the messages that advisers and product producers actually conveyed to potential investors in MIS. The courts have also grappled with the difficulty in determining the actual content and nature of the advice that product issuers and advisers offered their clients—whether it was deceptive, misleading, whether risks were appropriately identified and emphasised or important information omitted. They have to weigh up the written record with undocumented recollections. Although not dealing with agribusiness MIS, the courts have commented on this difficult task. For example, Justice Hulme had 'real doubts about the terms of the conversations concerning' investments where there was 'no reliable confirmatory documentary evidence'. Justice Hulme cited Chief Justice McLelland who in a judgement said:

> '[H]uman memory of what was said in a conversation is fallible for a variety of reasons, and ordinarily the degree of fallibility increases with the passage of time, particularly where disputes or litigation intervene, and the processes of memory are overlaid, often subconsciously, by perceptions or self-interest as well as conscious consideration of what should have been said or could have been said. All too often what is actually remembered is little more than an impression from which plausible details are then, again often subconsciously, constructed.'[64]

9.51 Justice Croft also referred to the fallibility of human memory and of the need to exercise care in evaluating the significance of memory, or the lack of it, with respect to events, conversations and documents experienced or encountered many

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62 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 11, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (9 December 2014).

63 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', 29 January 2010, p. 11, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (9 December 2014).

64 Tomasetti v Brailey [2012] NSWCA 399 (11 December 2012) [34] [393] and Tomasetti v Brailey [2011] NSWSC 1446 (17 November 2011) [393].

years ago. He cited a statement of approach which appeared in the judgement of Justice Lewison:

> Witnesses, especially those who are emotional, who think that they are morally in the right, tend very easily and unconsciously to conjure up a legal right that did not exist. It is a truism, often used in accident cases, that with every day that passes the memory becomes fainter and the imagination becomes more active. For that reason a witness, however honest, rarely persuades a Judge that his present recollection is preferable to that which was taken down in writing immediately after the accident occurred. Therefore, contemporary documents are always of the utmost importance. And lastly, although the honest witness believes he heard or saw this or that, is it so improbable that it is on balance more likely that he was mistaken? On this point it is essential that the balance of probability is put correctly into the scales in weighing the credibility of a witness, and motive is one aspect of probability. All these problems compendiously are entailed when a Judge assesses the credibility of a witness; they are all part of one judicial process and in the process contemporary documents and admitted or incontrovertible facts and probabilities must play their proper part.[65]

9.52 The committee was similarly placed in attempting to reconcile the accounts of past conversations with advisers and scheme promoters with contemporaneous written documentation such as the PDS. While the written evidence told one story, many growers were recalling a very different version.

9.53 The committee has discussed at length the trust that clients placed in their financial advisers, even to the extent that some may have signed documents they did not fully read and did not comprehend. They looked to their adviser to interpret the information. Conversations between adviser and client, however, are not recorded and hence their contents cannot be verified.

9.54 Even so, it should be noted that the committee found the consistency of evidence produced from a range of different investors about their understanding of the risks identified with MIS cannot be discounted. It is persuaded that their accounts have validity. The committee contends that the written evidence, such as the PDSs relied on by the courts, does not capture the full breadth of advice that the investors received from the promoters and advisers: that PDSs do always convey the full story. Thus, even if disclosure documents complied with the regulations, investors may have received wrong messages or misinterpreted the information. In the committee's view, consideration must be given to the broader context in which advice is given.

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65 Annexure, Clarke v Great Southern Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 334 (25 July 2014) [60] to Clarke (as trustee of the Clarke Family Trust) v Great Southern Finance Pty Ltd (recs & mgrs apptd) (in liq) [2014] VSC 516.

Agribusiness PDS—scope for improvement

9.55 As mentioned above, matters such as yield projections contained in PDSs were based on a multitude of complex factors complicated further by the 'long investment horizon'. Thus, with their limited ability to unravel the risks in such forecasts, growers tended to rely on others to interpret the material for them.[66]

9.56 Industry Super Australia also noted that 'inadequate or unnecessarily complex disclosure documents have been a common theme in complaints regarding Forestry MIS'.[67] It suggested, however, that even where disclosure is of a high standard, it alone is not an adequate tool to protect consumers. It cited the findings of the FSI that 'many cases of financial firm failure include situations where consumers have failed to understand the risk/return trade-off involved in a product, even if disclosure and advice were compliant'.[68]

9.57 CA indicated that industry broadly recognised that there were deficiencies in the current disclosure regime and, because agribusiness MIS were complex, greater attention to the appropriate design of these products and their disclosure was required. It stated clearly that the industry needed to take 'greater responsibility and accountability in terms of both the advice provided and the products designed'.[69]

9.58 The committee also notes the conclusions reached by Mr Garry Bigmore QC and Mr Simon Rubenstein Barrister at the Victorian Bar, who, in a recent publication, acknowledged the practical difficulties for investors bringing claims for relief for defective PDSs, including an 'overly prescriptive, complex and poorly drafted liability regime in part 7.9 of the Corporations Act'. They wrote:

> The regime relies on and incorporates definitions within definitions and exceptions within exceptions. It is difficult for lawyers to get their heads around—let alone investors lacking in legal training.[70]

9.59 In their words, this part of the Corporations Act is 'a prime illustration of confusing legislative drafting'.[71]

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66 Christine Brown, Colm Trusler and Kevin Davis, 'Managed Investment Scheme Regulation: Lessons from the Great Southern Failure', January 29, 2010, p. 11, http://kevindavis.com.au/secondpages/workinprogress/Great_Southern_JASSA-v2-28-1-10-3.pdf (9 December 2014).

67 *Submission 136*, p. 3.

68 *Submission 136*, p. 4.

69 *Submission 143*, pp. 3 and 4.

70 Garry T Bigmore QC and Simon Rubenstein, 'Rights of Investors in Failed or Insolvent Managed Investment Schemes', in Stewart J Maiden, (ed), *Insolvent Investments*, LexisNexis Butterworths, 2015, pp. 237–238.

71 Garry T Bigmore QC and Simon Rubenstein, 'Rights of Investors in Failed or Insolvent Managed Investment Schemes', in Stewart J Maiden, (ed), *Insolvent Investments*, LexisNexis Butterworths, 2015, p. 238.

9.60 In response to a question on the practical difficulties bringing claims for relief for defective PDSs, ASIC noted that the liability regime in part 7.9 sets out the consequences for failure to comply with the various obligations with respect to a PDS and its interaction with the consumer protection provisions in the ASIC Act. It agreed that the provisions are 'relatively complex and may be difficult to navigate'. ASIC also highlighted the challenge for investors having to wade through these documents and, based on its experience regulating retail financial markets, noted:

> …people often do not read mandated disclosure documents, inadequately understand or even misunderstand those documents, particularly where the financial product involved is complex and/or the document is lengthy. The difficulty for investors in establishing that they relied on information in a PDS and suffered loss or damage as a result of being given the PDS, is more closely aligned to issues arising from the limitations of disclosure in addressing market failure.[72]

9.61 ASIC acknowledged further that certain limitations mean that disclosure is not always sufficient for the task of 'arming investors and financial consumers with key information to guide decision making'.[73] It noted that the Timbercorp and Great Southern class actions failed because in each case it was found that:

- the impugned PDSs were not defective, in that they did not contain misleading statements or omit information that should have been disclosed; and
- the plaintiffs failed to establish that they relied on the PDSs, and consequently, that they suffered loss and damage because they were given the PDSs.[74]

9.62 In January 2012, to assist investors in agribusiness ventures, ASIC released an agribusiness MIS regulatory guide with five new disclosure benchmarks and five principles that apply to all agribusiness scheme prospectuses.[75] These benchmarks were designed to help retail investors understand the risks and rewards of the offer and to enable them to make a more informed decision. They include:

- more transparent fee structures;
- annual reporting to investors; and

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72 ASIC, answer to question on notice, No. 3, 2 October 2015, p. 28.

73 ASIC, answer to question on notice, No. 3, 2 October 2015, p. 28.

74 ASIC, answer to question on notice, No. 3, 2 October 2015, p. 27.

75 Government response, The House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees: Inquiry into the future of the Australian Forestry Industry*, June 2013, p. 12, http://www.agriculture.gov.au/SiteCollectionDocuments/about/obligations/reports-tabled-in-parliament/inquiry-into-the-future-of-the-australian-forestry-industry.pdf (accessed 22 September 2015).

- disclosure of engaged third parties and their qualifications.[76]

Context of information—oral advice, wealth seminars

9.63 The committee has already highlighted the importance of considering the context in which advice is provided when determining whether the investor was appropriately informed particularly of the risks associated with an investment. The committee has referred to financial advisers often interpreting or misinterpreting the contents of disclosure documents for the clients. In this regard, the FPA argued that product manufacturers should be accountable for information acquired and contained in their PDS. In its view, the failure occurred whereby the product manufacturer put inaccurate harvest figures in their product disclosure statements:

> The product manufacturer should have been aware of that, and should certainly have been correcting it in the future, but should have been looking at what was realistic. That information has then been used second hand and third hand further down and obviously from an incorrect basis.[77]

9.64 But such documents, as well as glossy brochures, are also presented during promotional or information seminars.

Promotional events

9.65 Product issuers must also be responsible for the way in which they present disclosure documents such as the PDS. The committee has mentioned the high pressure tactics used by some advisers to convince their clients to invest in an agribusiness MIS. But investors were often primed by managers and product promoters, as well as accountants and financial advisers, at information or marketing events.[78] A number of submitters referred to their advisers as salesmen, not financial advisers, who were not providing advice but merely selling a product not suited to their clients' needs and from which they profited. For example, one couple went along to one such investment session:

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76 Government response, The House of Representatives Standing Committee on Agriculture, Resources, Fisheries and Forestry, *Seeing the forest through the trees: Inquiry into the future of the Australian Forestry Industry*, June 2013, p. 12, http://www.agriculture.gov.au/SiteCollectionDocuments/about/obligations/reports-tabled-in-parliament/inquiry-into-the-future-of-the-australian-forestry-industry.pdf (accessed 23 September 2015). See also, ASIC, Regulatory Guide 232, *Agribusiness managed investment schemes: Improving disclosure for retail investors*, January 2012, http://download.asic.gov.au/media/1246956/rg232.pdf (accessed 23 September 2015).

77 Mr Neil Kendall, *Proof Committee Hansard*, 6 August 2015, p. 27.

78 Robert and Lynne Powell, *Submission 5*; Mr Anthony Jayantha, *Submission 29*; name withheld, *Submission 89*, p. [1]; name withheld, *Submission 53*; name withheld, *Submission* 56; *Kevin and Cristina Lee*, *Submission 174.* See also, ASIC, Report 17, *Compliance with advice and disclosure obligations: Report on primary production schemes*, February 2003, p. 19. One investor referred to 'inspiring seminars and "hype"', Mr David Abraham, *Submission 64*, p. [1].

> There was a seminar held at the Hilton Hotel in George Street around this time in early 2008 which was attended by hundreds of people. Once again there was a mixture of various people from all walks of life but this time the attendance was the largest we had seen. The audience was addressed by Steve Navra and other representatives from Great Southern all of whom were extremely positive towards the scheme and all of the great plans they had in place at that time.[79]

9.66 Many were persuaded to invest by slick and compelling sales tactics: by talk of the 'returns so beautifully outlined and promised in the prospectus'.[80] As noted earlier, a number of the growers referred to being reassured by reference to the ATO and ASIC's endorsement of the scheme.[81] As one grower explained:

> I was provided with many glossy brochures, and the forecast returns looked healthy plus the scheme was endorsed by the ATO with the tax credits which made my decision to sign up seem like a good idea. I was happy I was doing something positive with my money and taking charge of my future to look after my family so as I didn't have to rely on Government handouts during my retirement years.[82]

9.67 A wife described how her husband was invited to a seminar where he was urged to sign up for a guaranteed return and without any discussion of risk.[83] In greater detail, an investor recounted:

> For each of the two years during my investment, my financial adviser had an evening seminar attended by a director/manager from TC [Timbercorp]. At the last such seminar a TC director was questioned on the risk to their projects if the government stopped the MIS schemes. His reply was that they were lobbying to have this not implemented and there is no risk to existing projects.[84]

9.68 One investor, who considered herself an ordinary, everyday suburban mother, also referred to the pressure to sign up for a 'rock solid project', stating that:

> Timbercorp products were promoted and highly marketed during dinner presentations and group discussions with investors. The representatives

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79 Name withheld, *Submission 56*, p. [3]. See also Mr McShane who referred to brochures and of attending very professional and well conducted seminars, which looked 'fantastic'. He expounded on the beauty of the scheme and how well it worked. *Proof Committee Hansard*, 6 August 2015, p. 10.

80 Name withheld, *Submission 96*, p. [1].

81 See, for example, Mr Andrew Reibelt, *Submission 104*.

82 Mr Michael McLeod, *Submission 87*.

83 Name withheld, *Submission 162*.

84 *Confidential Submission 140*, p. 1.

> were at liberty to change and alter loan applications forms on the spot, without consulting with Timbercorp Finance.[85]

9.69 Yet another investor wrote of how investment managers organised flashy dinner get-togethers and well-polished seminars and materials that 'all promoted their Australian Tax Office approvals and low risk returns'.[86] They created a 'perception of security and a failsafe investment'.[87]

9.70 The sophisticated marketing techniques employed by marketing people well versed in the art of selling financial products exerted significant influence over inexperienced investors. The committee has also commented on the trust that investors placed in their financial advisers. Thus, when considering any regulatory change, it is imperative that the government take close account of the findings of behavioural economists and the evidence presented to this inquiry that:

- retail investors may have difficulty deciphering the information contained in the PDS and hence do not comprehend adequately the significance of the risks as presented (or disguised) in disclosure documents;
- small investors tend to place the utmost trust in their adviser's recommendations, they do not always read information contained in key documents such as prospectuses, PDSs and statements of advice, and rely on their adviser to interpret this material for them;
- despite statutory obligations, advisers and product issuers do not always act in the best interests of the clients and may deliberately withhold, conceal or downplay important information—indeed, in the case of financial advisers, some appeared to have conveyed false impressions (or allowed them to take hold): for example, that the schemes were government and ASIC approved and optimistic yields were achievable;
- key information contained in glossy brochures, prospectuses and PDSs, and sometimes cited or distributed during promotional seminars, may not always help investors understand the product and its risks and instead may serve to obscure not inform; and
- highly charged marketing events—seminars and dinners—may be ideal vehicles for product issuers to promote and sell their products but without appropriate consumer safeguards can work to disadvantage potential investors.

9.71 The committee stresses that the context in which advice is provided—sales techniques and trusted financial advisers—is a potent influence and should not be underestimated. Disclosure documents, such as PDS, must be considered in this

85 *Confidential Submission 92*, p. [2] (emphasis in original).

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

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

context, which further demonstrates why PDS must disclose, in a clear, concise and comprehensible way, all information required to enable an investor to make an informed decision. They must clearly spell out the risks associated with the investment.

9.72 The FSI report supported the need for mandated product disclosure. In its view, such disclosure was 'necessary to inform the market and to support issuers and consumers in setting out the terms of their contract'. The FSI saw, however, scope to provide issuers with more flexibility to communicate mandated disclosure to better engage and inform consumers.[88] It recommended:

> …a self-regulatory, flexible approach to improving communication of risk and fees, allowing tailoring for different classes of products and avoiding prescriptive regulation, which would involve higher compliance costs. Industry should build on existing measures to improve consumer understanding of risk by including risk measures for investment products; for example, simple and non-simple MISs, securities and structured products. Industry should also consider examples of risk measures used in Europe and Canada.[89]

9.73 From the investor's perspective, the disclosure of risk in many agribusiness disclosure documents was not presented in a clear and comprehensible way and definitely not in a way that would have alerted them to the risk accompanying the schemes. The range of misconceptions chronicled in this report attests to the inadequacy of PDS on agribusiness MIS and the advice that accompanied their presentation.

Conclusion

9.74 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.[90] Disclosure documents—prospectuses, PDS and SOA—proved inadequate in alerting consumers to the risks of investing in agribusiness MIS. The shortcomings in the disclosure statements together with unsound financial advice and slick promotional strategies created an environment unsuited to informed and considered decision-making.

9.75 Clearly, product manufacturers and issuers should be held accountable for the information contained in their promotional material and disclosure documents. Such

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88 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 214, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

89 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 216, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

90 See, for example, observations by the Financial Planners Association, *Submission 161*, p. 7 and quoted later in this report at chapter 14, paragraph 14.6.

information must be accurate and comprehensible to retail investors and relevant to their investment decision. The evidence 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, as a consumer protection mechanism, disclosure documents have not always served retail investors well. While these documents could be clearer; easier to comprehend; and better designed to inform the investor of risk, the product issuer and financial adviser must take responsibility for ensuring that the promotion and marketing of the product facilitates informed decision making. Without doubt, evidence before the committee supports the contention that retail investors need robust consumer protection and the reliance on disclosure documents left growers exposed to risks they did not understand.

9.76 The committee is of the view that the time is ripe to examine once again the efficacy of PDSs when it comes to conveying information to retail investors and enabling them to make informed choices.

Recommendation 8

9.77 The committee recommends that, based on the agribusiness MIS experience, the 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.

9.78 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.

9.79 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.

9.80 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.

9.81 In the following chapter, the committee continues its consideration of the manner in which product issuers promote and sell their products. Recognising the current weaknesses in the disclosure regime, the committee, in chapter 14, explores whether MIS should have been marketed to retail investors in the first place. The committee is primarily concerned with regulations governing the product being sold.