

4 June 2010

Mr Rupert Smoker and Mr Paul Eastment  
Senior Managers  
Investment Managers  
Australian Securities and Investments Commission  
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Dear Mr Smoker and Mr Eastment

**ASIC CONSULTATION PAPER 133  
AGRIBUSINESS MANAGED INVESTMENT SCHEMES: IMPROVING  
DISCLOSURE FOR RETAIL INVESTORS**

McMahon Clarke Legal (MCL) welcomes the opportunity to make a submission on ASIC's consultation paper 133 *Agribusiness Managed Investment Schemes: Improving disclosure for retail investors* (CP 133).

**About MCL**

McMahon Clarke Legal was established in 1994 and has been active in the agribusiness investment sector for all that time. Our clients include managers and trustees under the former prescribed interest regime (the predecessor to the managed investment laws now in place) and we now act for responsible entities, custodians and other stakeholders operating in the agribusiness managed investment sector.

We have been very focused on legislative reform, particularly in the area of managed investment schemes. One of our partners, Langton Clarke, wrote the book *Everything you need to know about agricultural investment prospectuses: establishing a project under the Managed Investments Act 1998*. He was also president of the *Managed Investments Industry Association*, a company established to facilitate the development of Australian primary and developing industries through ethical and innovative managed investment products.

**CP 133**

ASIC proposes introducing disclosure benchmarks for agribusiness managed investment schemes (MIS). In CP 133, ASIC notes the benchmarks are designed to improve disclosure for retail investors to enable more informed decisions about

investments into the agribusiness MIS sector and make comparisons between schemes more straightforward.

ASIC first introduced benchmark disclosure requirements in 2007 for unlisted, unrated debentures. Since then, similar requirements have been introduced for mortgage managed investment schemes and consultation paper 134 on improved disclosure by infrastructure entities is currently open for consultation.

As with current benchmark disclosure requirements, compliance with the benchmarks is not mandatory, but disclosure against them is, so that product disclosure statements (PDS) promoting agribusiness MIS and ongoing disclosures must address the benchmarks on an 'if not, why not' basis.

### **Preliminary comments**

We provide submissions on some of the specific benchmarks below, however our preliminary comments on CP 133 are as follows:

1. On the basis the list, nature and scope of the benchmarks is optimum, then the 'if not, why not' disclosure regime, and the objectives to be achieved, are understandable. However, the principal problem with such an approach is that any failure to comply with a benchmark often leads to significant adverse reputational and marketing implications. Whilst compliance with the benchmarks is not mandatory (only disclosure against them is) 'perception is reality' for many prospective investors who can misconstrue the purpose and effect of the disclosure benchmarks and the reason for a negative response to any of them in a PDS. The perception will exist in the marketplace that ASIC has a preferred set of structural components for an agribusiness MIS and failure to comply with those benchmarks will be adversely perceived.
2. ASIC's investor protection focus in the agribusiness MIS sector is understandable. However, linked to our comment in the preceding paragraph, agribusiness MIS, like any agricultural enterprises, are an inherently risky investment. ASIC's role, and industry's obligation, is therefore to ensure appropriate disclosure of the attendant risks, not to create a low-risk investment product.

Some of the terminology used in CP 133 could therefore be misconstrued. For example, paragraph 10 on page 8 of CP 133 provides that the purpose of disclosure benchmarks is, among other things, "...to enhance investor confidence". We are unsure whether this is what is intended. It could be interpreted that the purpose of the disclosure benchmarks is to enhance the confidence of investors in the scheme in which they are investing and the possible investment returns and outcomes from doing so. If this is in fact what was intended, then we query whether the role of the corporate regulator is to effectively create or mandate an optimum investment structure. Instead, what should be promulgated is full, clear and effective disclosure which is clearly what CP 133 is aimed at. Consideration should therefore be given to

the investor confidence terminology throughout the consultation paper and any ultimate regulatory guide which is produced.

3. We consider the commencement date of the new disclosure requirements (being 30 September 2010) is a very short timeframe, particularly if responsible entities are required to disclose against the benchmarks for each agribusiness scheme.
4. We challenge the intended effectiveness of responsible entities of existing schemes addressing the benchmarks in updated disclosure that is brought to the attention of existing investors (CP 133.31).

Agribusiness MIS are illiquid so unless an investor can source and negotiate a sale of their scheme interest to a third party, the investor must remain in the scheme. What purpose is therefore achieved by receiving an ‘if not, why not’ disclosure against benchmarks which did not exist at the time the investor entered the scheme?

5. Finally, disclosure against the benchmarks will lead to longer PDSs, even if only by one to two pages.

### **Benchmark 1: Fee structures**

Benchmark 1 requires disclosure about whether members pay annual fees based on the actual scheme operating costs and whether the responsible entity of the scheme is custodian to hold scheme assets. The rationale behind annual fee structures, as opposed to deferred fee payments, is understandable in light of the recent significant corporate collapses in the agribusiness MIS sector.

This is a stark example, however, of the perception of an ASIC preferred structure.

Further, we query the reference to use of a custodian. Table 2 on page 15 of CP 133 describes the disclosure benchmark as “the responsible entity uses the custodian to hold assets of the scheme” and then under the ‘if not, why not’ explanation provides that a responsible entity must explain what safeguards exist to ensure annual fees paid by members are appropriately segregated from the assets of the responsible entity and are used for a proper purpose, if the responsible entity does not use the custodian to hold scheme assets.

Our first comment is a responsible entity can act as custodian if the financial requirements and other custodial standards set out on its AFS licence and in ASIC regulatory guide 133 are met.

It is therefore incongruous to establish a benchmark contemplating third party custodianship, when the AFS licence conditions and ASIC policy allow self-custody.

Secondly, assuming third-party custodianship is required, it is arguable that ongoing fees (as opposed to application fees) payable by investors pursuant to individual agreements entered with the responsible entity (such as management

agreements and leases or licences of an allotment of land) do not amount to scheme assets. We question therefore whether the disclosure benchmark should refer to a custodian holding assets of the scheme when the fees may not be properly characterised as such. Given the apparent preference that fees be held by a custodian, the benchmark should therefore use words to the effect of “The responsible entity uses a custodian to hold annual fees paid by members”.

### **Benchmark 2: Track record of the responsible entity in operating agribusiness MIS**

As a preliminary comment, the summary of this benchmark in table 1 on page 10 of CP 133 provides a benchmark to address “how successful” previous agribusiness schemes have been. We consider the reference to success is subjective and capable of many different connotations. We note the detail of this disclosure benchmark on pages 17 to 18 does not in fact then refer to “success” but, more correctly in our view, requires disclosure whether previous agribusiness schemes have met disclosed forecasts.

Our comments on this particular benchmark are as follows:

1. Since the advent of ASIC’s regulatory guide 170 *Prospective financial information*, the ability to provide forecasts in an agribusiness MIS offer document has been severely restricted. In fact, it is extremely rare to see forward looking financial statements in any agribusiness MIS offer document.

Many responsible entities will therefore need to disclose that they do not meet the benchmark and whilst this may be reasonably explained away, a negative response to ASIC’s prescribed disclosure benchmark will have negative implications for a responsible entity, in circumstances where there has been no ‘fault’ on the responsible entity’s behalf.

Ideally, there could be a middle ground which can be adopted here, such as answering “not applicable” with an appropriate explanation but that has not been promulgated by ASIC as an available option.

2. Many forestry responsible entities in particular will be unable to address the benchmark accurately, even if they did include forecasts in their offer documents simply because harvesting has not yet occurred.

### **Benchmark 5: Responsible entity financial position and use of funds raised**

CP 133 sets out the rationale behind this benchmark that the responsible entity of an agribusiness MIS should be a going concern in its own right. Whilst we understand ASIC’s rationale, we submit commercial reality is that subsidiaries are often reliant on their parent companies to various degrees. It is trite to note this is entirely lawful.

We specifically query paragraph 50 on page 22 of CP 133 which provides that the responsible entity of an agribusiness MIS “...should not enter into any cross guarantees or other financial support arrangements for its ultimate parent or other group company”.

A responsible entity can remain a going concern in its own right even if it does enter into such arrangements. The whole rationale behind benchmark 5 is to ensure disclosure about the responsible entity’s management of its schemes’ cash position and whether the responsible entity is reliant on funding from external or related parties to perform its functions. The reference in paragraph 50 is to financial arrangements going the other way, namely from the responsible entity to related parties. Whilst this may not be a sound practice in light of some of the corporate failures in this sector, we consider the terminology should be amended or added to for the reasons given above.

### **Benchmark 7: Related party issues**

Related party transactions are often a sensitive issue and we agree disclosure of them is absolutely paramount. However, benchmark 7 clearly goes further than related party transactions. The disclosure benchmark requires disclosure whether any services agreements entered into by the responsible entity in respect of the scheme are—

1. disclosed to investors
2. subject to a competitive process
3. subject to annual review against set performance requirements, and
4. approved by the responsible entity’s board.

There is no reference in the disclosure benchmark to related party transactions. Furthermore, in the ‘if not, why not’ explanation ASIC explicitly refers to “non-related parties”.

Whilst the rationale behind this benchmark and disclosure of entering into services agreements is understandable, if ASIC wants that disclosure for **all** services agreements and not just those entered by related parties, then it should be clear and express and not refer to the disclosure benchmark as one relating to related party arrangements only.

### **Benchmark 8: Land, licences and water—related issues**

The underlying protection of land used in agribusiness MIS has long been an issue for ASIC and the industry alike. It was a requirement in the prescribed interest regime, more than twelve years ago, that the trustee of a scheme held a registered lease over land on which an agribusiness scheme was operated. The reality has shown that a registered lease however does not necessarily protect investors in a scheme when the tenant (whether it be the custodian or responsible entity) fails to

pay rent or otherwise does or fails to do something which exposes the lease to being terminated.

Our comments on this disclosure benchmark are as follows:

1. The benchmark does not contemplate dual structure schemes (often used in non-forestry schemes) where in addition to the agribusiness MIS conducted on the land, investors also hold units in a property trust, or shares in a company, which owns the land on which the agricultural enterprise is conducted. That type of structure does not meet ASIC's benchmark because the land is not part of the agribusiness scheme assets nor is it owned by members of the agribusiness scheme. Instead, it is separately owned by a company or another registered managed investment scheme (like a property trust). Nevertheless, the tenure security is as effective given dual structure schemes invariably require investors in the agribusiness MIS to also be investors in the underlying property owning vehicle (either directly or through associated entities such as superannuation funds).
2. CP 133 makes no mention of the protection of underlying land condition which is part of the Australian financial services licence of all responsible entities operating agribusiness MIS. If those licence conditions are not changed to reflect CP 133, then a responsible entity can technically comply with the licence condition but still not meet the benchmark.
3. For the purpose of AFS licence authorisations, will new agribusiness MIS which do hold land be regarded as direct real property schemes as well? If so, will the usual direct real property qualifications, experience and expertise requirements imposed by ASIC now need to be met by agribusiness MIS responsible entities and their responsible managers?

### **Benchmark 9: Third party financing arrangements**

The disclosure benchmark refers to the responsible entity or a related party "arranging for finance" to be provided to scheme members. This would therefore mean that the responsible entity or its related party could source and arrange a finance package from a mainstream lender and must still disclose against the benchmark.

We appreciate that some responsible entity-arranged finance packages have led to a variety of problems, including lack of disclosure of their full recourse nature. However, we query whether ASIC intended this benchmark disclosure to extend to those circumstances where a responsible entity is able to secure a package by a third party financier, including mainstream lenders, but otherwise has no involvement in the process other than advising prospective investors that the third party is willing to lend to enable participation in the scheme. Presumably, those lenders would then have their disclosure obligations to their borrowers which obviates the need for disclosure in the PDS.

We welcome the opportunity to expand on any part of this submission if ASIC requires.

Sincerely

A handwritten signature in black ink, appearing to read 'L. Clarke', written in a cursive style.

Langton Clarke

**Partner**

**McMAHON CLARKE LEGAL**

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