

GTA Industry submission – TGD No.4 Operating Standards for Pool Providers – Round 2 submission



AgRisk Management Pty. Limited – GTA Member No. 67

Introduction

AgRisk Management Pty. Limited (TA Market Check) fully supports the review of TGD No. 4 Operating Standards for Pool Providers being facilitated by Grain Trade Australia, and thanks all involved in the technical committee. Unfortunately thus far the sub-committee has failed to adequately address many of the previous items submitted by GTA members.

1.1 Issue (additional to content of current TGD) – inadequately addressed to date

Estimating future returns is something rare and quite unique to the grain industry. Use of estimated returns, in any context, has the potential to cause significant damage the whole industry, and the continued use, sanctioned by GTA, could result in greater regulation of the pools sector. Since deregulation, final pool returns have consistently underperformed, compared to ESR/EPRs advertised during the decision window (at harvest). EPRs/ESRs advertised at harvest are a legacy of the single desk, where there was only one pool provider, AWB. Now we are in a fully competitive market, they are being used as a marketing tool, by some pool providers. See attached Wheat Export Authority report “Estimated Pool Returns the Relationship to Final Price” and our own internal review (published in the Australian Grain Review). The primary findings of the “Estimated Pool Returns the Relationship to Final Price” report were:

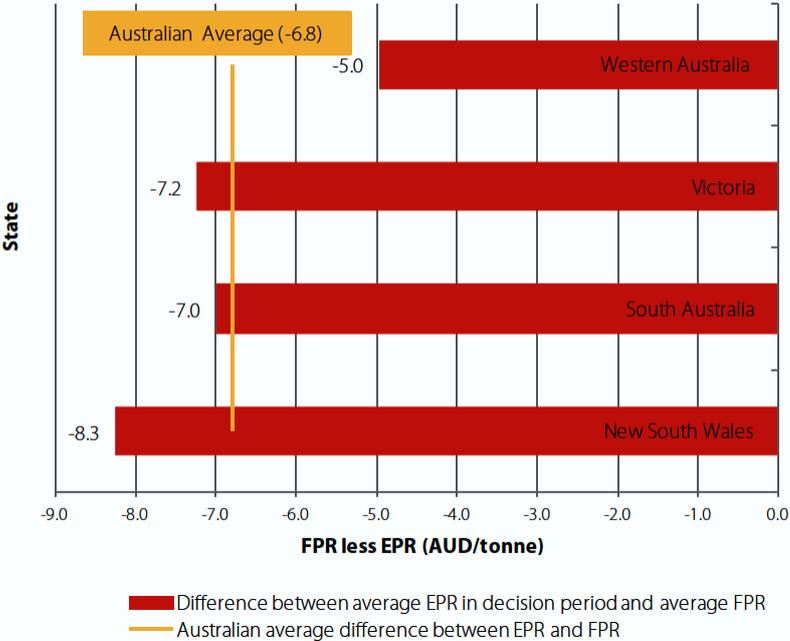
- 1. Estimated Pool Returns (EPRs) are, on average, higher than Final Pool Returns (FPRs), and**
- 2. EPRs are not a reliable predictor of FPRs.**

As far back as 2012 there were issues clearly identified with EPR/ESR's, which preceded the first TGD No.4 being released. Figure 3, demonstrates the issue on a state by state basis.

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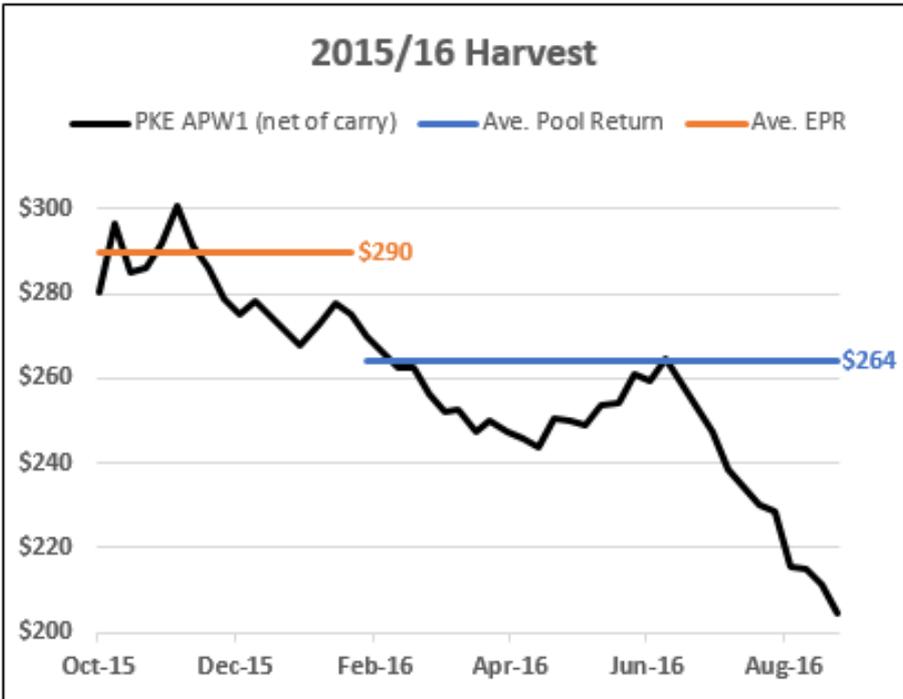
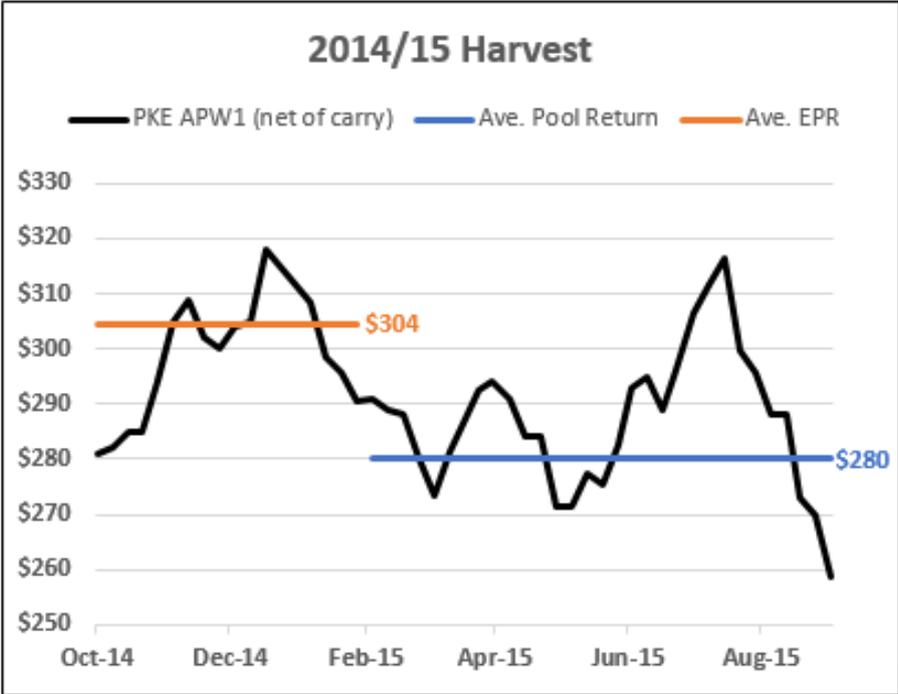
Figure 3: State by state difference in average decision period EPR and FPR for 2009/10, 2010/11 and 2011/12



Data source: Profarmer.

Since this time there has been little to no improvement with EPR/ESR during the decision making window (during harvest / contracting into the pool), still being used as a marketing tool. See Graphs below for 14/15 and 15/16 season EPR/ESR's during harvest and the final pool returns. In essence, EPRs advertised at harvest are misleading and should be prohibited. On review of 4 pool providers in the past 2 seasons EPRs were over inflated by an average of \$20 from the November figure compared to the final pool result.

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1.2 Impact on member business

Some pool providers have consistently been publishing EPR/ESR's during harvest which are significantly above the best cash bid in the market. This sets unrealistic expectations for

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growers who pool their grain with those providers. When the final pool returns are well below the EPR/ESR's advertised, it adversely effects all pool providers as it creates a lack of confidence in the pools sector of the industry in general. Should this practice be continued it could well be deemed deceptive or misleading advertising and therefore come under greater scrutiny from ASIC and the ACCC. If the industry continues to be reactive instead of proactive on this, at some stage it will come back to negatively impact the pool management sector, with enforced regulation similar to that we have seen in the agricultural managed investment scheme industry. This would also impact participating growers through reduced returns as a result of increased compliance costs being passed on, and also through a reduced number of pool products available to Australian grain growers.

1.3 Recommendation

The TGD No. 4 Operating Standards for Pool Providers, should be updated to:

Completely ban the advertising / publishing of EPR/ESR's during contracting (decision window / harvest) period. Contracting into a pool should be based on growers informed decision based on the pool providers' strategy, personnel, risk management and compliance systems, along with past performance of those products in a range of marketing environments. Contracting should not be based on a subjective number published by the pool provider. The use of estimated returns, even after a pool is closed for contracting, should also be prohibited, and replaced with a valuation methodology, using accepted accounting standards.

2.1 Issue (requirement of current TGD) – inadequately addressed to date

No proactive audit or enforcement of compliance with TGD No. 4 Operating Standards for Pool Providers by GTA. In the reviewed TGD all the responsibility has been placed on the auditor (who is paid by the pool provider) to monitor and enforce these guidelines. We have sought quotes from top tier accounting firm Price Waterhouse Coopers, who were unwilling to provide a quote or price estimate as significant portions of the standard remain unauditable, due largely to the subjectivity of much of the code and broad statements that are included throughout.

2.2 Impact on member business

Without any proactive audit or enforcement some pool providers are not complying with the code of practice and or TGD No. 4 Operating Standards for Pool Providers. All action

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appears to be reactive, waiting for a dispute or complaint to be raised by another member or industry participant (e.g. grower). This therefore presents a risk to all pool providers who are adhering to TGD No. 4 Operating Standards for Pool Providers.

The whole pool management sector will be impacted by regulatory intervention, and therefore the industry needs to proactively and transparently audit and enforce TGD No. 4 Operating Standards for Pool Providers. Currently there have been no complaints or disputes raised via GTA regarding the operating standard, however legal proceedings against pool operators has occurred. All complying pool providers will benefit from a more robust and proactive approach to auditing compliance with TGD No. 4 Operating Standards for Pool Providers, as part of Australian Grains Industry Code of Practice.

2.3 Recommendation

GTA be more proactive in managing this risk and make available (via website and/or regular communications) a list of pool providers and the corresponding annual audit reports (including compliance with TGD No. 4 Operating Standards for Pool Providers of each pool provider).

Those not complying should be suspended from GTA and industry participants (not only GTA members) be made aware (via website or other appropriate communication media) of the suspension and the reason(s) (non-compliance with TGD No. 4 Operating Standards for Pool Providers) for the suspension. Suspension should remain in place until the pool provider (member) complies with these requirements or cease to operate pools.

Prior to adopting the code / standard GTA should seek external advice from a top tier auditing firm (PwC, E&Y, KPMG or Deloitte) to confirm which sections could (or can) be audited to a proper standard.

3.1 Issue (additional to content of current TGD) – Not addressed to date

A general lack of awareness of the GTA Code of Practice and TGD No. 4 Operating Standards for Pool Providers. In particular growers, as all communications are only to GTA members which excludes any growers who are not members of GTA. This includes complaints / dispute management processes available to ALL industry participants.

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3.2 Impact on member business

GTA Code of Practice and TGD No. 4 Operating Standards for Pool Providers, is only communicated to GTA members, and not ALL industry participants, in particular Australian grain growers who use the products. As the consumers of pools products are important industry participants, they should be made aware of the GTA Code of Practice and TGD No. 4 Operating Standards for Pool Providers. As such the majority of growers would not be aware of the complaints & dispute resolution options that are available to them should they be unhappy with the behaviour and or performance of a pool provider.

3.3 Recommendation

GTA to communicate the Australian Grains Industry Code of Practice & TGD No. 4 Operating Standards for Pool Providers with ALL industry participants. Investigate and implement the best ways to more effectively & efficiently communicate with Australian grain growers (pool product consumers and grain industry participants) and NOT just GTA members.

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Detailed feedback on DRAFT documents

TGD No. 4 Operating Standards for Pool Providers

Section 1

Would this required to be audited by external accredited auditor? If so, how would this practically occur and how would this be enforced?

Section 2

Would this required to be audited by external accredited auditor? If so how would this practically occur? How would this be enforced?

Section 2.9

Requires standardised method of valuing pools assets and liabilities net of all fees and associated costs.

Prohibit publication of EPR/ESR during contracting, as unable to determine mark to market on physical pool tonnes or any derivative products used to manage risk.

Section 2.9.3 – “(including estimates of any costs and fees)”

As this is a FINAL pool return there should not be any estimates, they should be actual figures.

Section 2.9.4 – “less the applicable freight”

Open to too much interpretation and potential to be abused ('manipulating' returns), suggest making it 'applicable GTA location differential'. This will also ensure location differentials are accurately and equitably determined by the industry at the same time.

Section 2.9.6 – “associated provider”

This is the only area in the document where this is used, what is it referring to, and should it be defined in the definition section?

Section 3 (a), b), c), d), f), g))

How will these be practically audited and enforced?

Section 3 i) & k) – “Clause” vs. “section”

Document needs to reference areas of the document consistently, sometimes they are referred to as 'sections' and sometimes as 'clauses'. Use of one term would be more consistent.

Section 4 c) – “that EPR will be a fair and reasoned estimate that the Pool Provider will be able to justify to Pool Participants at the time it is posted.”

How practical is it for this to be audited? With EPR/ESR's being published on boards at sites on a daily basis, also on various websites and apps.

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Section 4 d) – “The Pool Provider must:

- *Clearly state the grounds for any forward-looking EPR published.*
- *Include a statement that EPRs are ONLY estimates and are NOT to be relied upon as an accurate predictor for pool performance.”*

How practical is it for this to be audited? With EPR/ESR's being published on boards at sites on a daily basis, also on various websites and apps.

Section 4 g) – “as soon as practical”

This should be tightened to reflect an actual period of time, not open to interpretation. Suggest removing any ambiguity.

Section 5 – “Reporting and audit control”

Significant issues have been raised regarding the auditability of the standard, before even looking at the whole GTA Code of Conduct. To date this has not been addressed adequately by the sub-committee and is integral to the successful implementation and enforcement of the code. We would suggest a top tier auditor is engaged to review standard and by associated the Code of Practice to ensure the practicality of auditing pool providers to the Code of Practice and associated standards (e.g Technical Guideline Documents). Should it also require that ALL GTA members be audited (at least annually) the Code of Practice to maintain their membership. It feels like the Pools industry is unfairly carrying the burden of industry self-regulation, and the only business required to be audited to the complete Code of Practice.

Section 5 d) – “specifically the definitions of FPR, GPR and Underwriting”

Should it be all definitions? Unsure why these definitions need special reference in this section. Suggest removing or place equal emphasis on ALL definitions (including EPR/ESR, if included).

Section 5 d) – “The Pool Provider has:

- *the appropriate skills,*
- *payment systems,*
- *risk systems and procedures,*
- *governance and compliance protocols,*
- *policies and resources”*

How can this be audited cost effectively and transparently?

Section 5 d) – “to manage the Pools in Accordance with the TGD and the Australian Grains Industry Code of Practice”

How practical is it for pool providers to be audited to the complete industry code of practice?

This is a significant undertaking that would increase costs to pool providers and if costs were passed on to participants, it would reduce returns, reduce the number of providers, pool products and competition in the market.

Section 6 1.) – “basic guiding principles”

How auditable is this section. Suggest excluding from external audit requirements.

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Section 4 – “Recommended format for PPDG should:”

Is this too prescriptive, as long as the minimum content requirements are met, why it needs to dictate on length, font sizes and ‘headings and a contents page? Seems excessive to have a contents page for a document that is restricted to ‘8 A4 pages’. Then does the contents page count as one of those 8?

Section 7 – “General Principles”

This whole section is a little confusing. What is its primary objective? Is compliance with them mandatory and how practical is it to audit pool providers to each section. Will auditors be expected to audit all advertising, marketing material, communications (call recordings, emails and text messages) of pool providers to assess compliance? Suggest removing this section from those that need to be audited.

Section 7.2 a)

What are we trying to say here? It does not make sense.

Section 7.2 c) “the use of hypothetical or reconstructed past performance figures”

Very unclear what the objective is in this section. Either they are past performance (factual) figures supported by results, or they are not. Which would make them deceptive and or misleading statements, with participants able to take recourse under the Corporations Act, which protects consumers from this type of behaviour. As it is regulated by the Corp.s act and ACCC, are we doubling up on things here and making the audit more costly and impractical to administer and enforce.

Pool Product Disclosure Guide (PPDG)

1. Who 2. What

What is the difference between ‘Aim of Mandate of the Pool’ and ‘Aim of the Pool’. Are they the same thing? Is this confusing for pool participants? Does Pool Mandate need to be defined somewhere?

2. Key Details

Does this need to differentiate between EPR/ESR during contracting vs. after the pool is closed for contracting, when an accurate mark to market valuation can be determined using accepted accounting standards.

Would a FPR be mandatory requirement of a Pool product? If so why would there be a situation where a FPR would NOT be provided to participants?