



SUBMISSION

**Grain Trade Australia review of Technical Guideline Document (TGD) No.4
Operating Standards for Pool Providers.**

Date

February 2017

About Grain Producers Australia

GPA is a national Representative Organisation (RO) for the grains industry in accordance with the *Primary Industries and Energy Research Development Act 1989* (PIRD), and has key responsibilities under the *Primary Industries (Excise) Levies Act 1999* and the *Primary Industries (Customs Charges) Act 1999*.

GPA is supported by Grain levy payers in Australia and through direct grower members and state members in Grain Producers SA, VFF Grains Group, NSW Farmers Association, WA Farmers Grains Council, WA Grains Group, Tasmanian Farmers and Graziers and Agforce Grains.

Introduction

GPA welcomes the opportunity to provide feedback to Grain Trade Australia regarding Technical Guideline Document (TGD) No.4 Operating Standards for Pool Providers.

The GPA response will outline our concerns regarding the limitations of the TGD, the Code of Conduct with relation to the behaviour of pool providers and actions required by GTA to restore confidence in the provision of pools.

GPA believes the Code of Conduct and the TGD for Pool Providers, as currently written and enforced by GTA, are insufficient. They do not provide growers with the accountability measures they are seeking, nor do they appear to be being enforced appropriately by GTA. GPA has a number of recommendations to ensure growers concerns regarding current pool operations are met.

The current Code and TGD fails to provide pool participants with enough transparency and rigour surrounding pool provider's management of pools. The Code of Conduct needs to be more consistently included in the legal contractual arrangements. However, accountability won't be achieved unless GTA also undertakes and publishes analysis to both assess compliance with the Code and provide the information required to help industry amend the Code to make it more effective if necessary.

The ACCC guidelines for successful voluntary codes recommend that commercially significant sanctions will be necessary to achieve credibility with and compliance by participants, and also engender stakeholder confidence in the industry code.

GTA currently has no capacity for monitoring compliance within the Code and its administration, and there are currently no enforceable sanctions for non-compliance with the Code.

GTA notes in its public letter to the VFF in September 2014, "GTA Member organisations that do not adhere to the provisions of the Code can be expelled (p.4)." However, it does not indicate that non-complying organisations will be expelled, or that there is any formal process for these expulsion decisions.

Nor is there currently an easily accessible complaints process. The ACCC guidelines recommend a code should also provide for a review mechanism when a member of the public or an industry member is dissatisfied with an initial attempt to resolve the complaint. This internal review mechanism may be offered by the industry association to attempt to conciliate the dispute. If all internal industry efforts fail to resolve the complaint then the industry should sponsor an independent complaint body to review it.

Currently complaints handling is undertaken in accordance with the Complaints Handling Guidelines in GTA Technical Guideline Document No. 1.

The basic process is as follows:

Step 1. Initial complaint is reported to the organisation about which the complaint was made, which is allowed a “reasonable time to attempt to resolve the complaint”

Step 2. If the complainant feels that the complaint has not been “satisfactorily dealt with,” it may be referred to the ‘GTA Compliance Officer’ who will follow up if deemed appropriate.

Step 3 (if required). Complaint may be referred to a Disciplinary Tribunal consisting of 3 GTA Board Directors.

There is no indication within the Code or within the Complaints Handling Guidelines, or on the GTA website (as of 11th Feb 2016) as to whom the Compliance Officer is, or how they may be contacted. It is assumed that the ‘GTA Compliance Officer’ is the same as the ‘Code Compliance Officer’, who seems to be the GTA CEO.

The complaints handling process, including the Disciplinary Tribunal, does not currently include any independent members.

Also of concern amongst GPA members, is the opportunistic setting of EPRs. There is currently no method to ensure the companies have to be accountable for the EPR quoted. There needs to be a disincentive for inappropriate behaviour by setting measurable, transparent and comparable performance markers. GPA believes the recommendations outlined below will alleviate concerns and provide the necessary transparency and rigour.

GPA recommendation 1 – Pool Providers are required to produce a Product Disclosure Statement (PDS) which forms part of the terms and conditions of a pool and its contractual obligations with pool participants.

GPA is concerned about the current lack of consistent disclosure regarding pool products.

Without understanding the strategy, objectives, risks and costs of a pool, grain farmers are unable to accurately assess the commercial risk to their farming business of committing grain to the pool. Full disclosure will assist farmers in selecting the correct pool for them.

There needs to be a contractual onus on pool operators to operate the pool along that which is advertised. Mandating, as part of the GTA requirements, the provision of product disclosure statements will provide information to grain producers to enable them to make decisions over the strategy of the pool management and estimated returns, based on an understood duty in the preparation of Product Disclosure Statements (PDS). This will include the existing requirement for PDSs to be updated as material changes occur to the market or the management strategy.

Section 3 of the Guidelines refers to the Terms and Conditions of a Pool. These should be included in the PDS, which should form part of the terms and conditions of the pool.

Some of the necessary terms and conditions are covered in recommendations following. However, there are also some additional Terms and Conditions, which should also be included in the PDS:

- Strategy and management plan including sales plan,
- Goals or aims of the pool,
- Pool Management fees and costs,
- Risk mitigation strategy to be adopted by the pool, including hedging parameters and limits (not just the hedging or derivative products),
- If the pool is allowed to buy as well as sell physical product,
- Pool policies, for example when a pool will close such as when an EPR is under pressure,
- Shipping slot and freight trading tools to be used by the Pool Provider,
- If any hedging, physical trading or freight has been traded on behalf of the pool prior to commitment of growers,
- Related Party transaction rules including who the related parties may be, the terms of the transactions, transaction fees, whether management is separate/ring-fenced, audited, etc
- What 'entity' is the owner of the pool's grain inventory, where funds are held, and what capital backing the entity has, and

Pool Providers Qualifications (see recommendation 6 below)

GPA Recommendation 2 - The Operating Standards for Pool Providers technical document should be renamed *Pool Provider Code of Practice*.

GTA technical guidelines are not typically mandatory for GTA members with the exception of the Operating Standards for Pool Providers. Changing it to a Code of Practice would make it clear that members must comply.

GPA has significant reservations regarding the use of EPRs.

GPA recommendation 3 – GTA should investigate a standardised format for the quoting of Estimated Pool Returns, and put in place mechanisms to make companies accountable for their use of EPRs.

The guidelines already specify that EPRs must be quoted on a “net EPR basis”. However, GPA would recommend that the guidelines set out more precisely what

this means ie it means net of pool management fees and charges, storage/handling/logistics costs, risk management fees, interest and any other costs. The EPR published must be the actual return to be received by the growers, without any hidden charges to be further deducted.

EPR are also currently quoted at many different pricing points such as FOB and delivered port. This is very confusing for growers trying to compare apples with apples.

The net EPR basis should be quoted at 2 pricing points:

1. Delivered port basis where the only deduction is the “freight” deduction back to site
2. On a site basis (which just represents the difference between the Delivered Port price and the freight deduction)

As previously highlighted in the submission, the lack of accountability for actual performance versus EPR is of paramount concern to growers. GPA would like GTA to respond to these concerns by evaluating and responding to the following options:

- The EPR becomes recognised as the minimum payment for the pool.

This would ensure the companies have to be accountable for the EPR quoted. The grower has paid a management fee (\$5 - \$10 per tonne) to transfer price risk off “their book” and over to the “expertise” of the pool manager.

Setting the EPR as the minimum allowable contracted price would reduce the risk of opportunistic EPRs being quoted. It would also reduce the incentive for inappropriate behaviour by setting a measurable and comparable performance marker. It also allows for incorporation of the GTA trade rules for dispute resolution

- Pools guarantee a minimum price

GPA Recommendation 4 - The organisations compliance with their PDS should form part of the final pool audit and the results published.

Pools are currently audited based on accuracy of costs and revenue attributed to a pool. However, any audit should be extended to assess compliance of the pool with the PDS. For example, has the pool hedged in accordance with the method outlined in the PDS?

GPA Recommendation 5 - GPA supports stronger action by GTA to annually review and analyse pool provider performance against their PDS.

GPA believes there is call for action by GTA. Our members believe more appropriate oversight of pool providers will result in greater confidence in pool products by farmers.

Enforced accountability will also assist those pool providers doing the right thing and potentially reward greater innovation and competition between pool providers.

GPA Recommendation 6 - Pool Providers must provide clear and accurate information to illustrate they are qualified to operate a pool

When investing a substantial amount of money in any other industry it would be considered unacceptable not to have access to information regarding the personnel providing advice and running the service. Pool providers should meet the same expectation. The grower has paid a management fee (\$5 - \$10 per tonne) to transfer price risk off “their book” and over to the “expertise” of the pool manager.

Making pool providers provide and publish documentation regarding the qualifications of their staff will help growers assess their respective levels of expertise.

GPA Recommendation 7 - Pool operators must have appropriate systems, processes, and governance in place to operate Pool

An entire section needs to be included in the guidelines on what this means.

Pool providers must the following accurate and timely systems and processes in place:

- Contracting: records and issues contracts, contract execution and calculates contract balance and pool position
- Accounts Receivable: issues invoices and reconciles invoices to ownership transfers and payments to invoices
- Accounts Payment: pay and accrue for pool costs and grower payments
- Pool Equity: calculates pool equity based on sales, costs, accruals and mark to market of stock, open contract and hedges

EPR: compares EPR to Pool Equity

GPA Recommendation 8 - Pool Providers must mandatorily report EPR and Pool Equity on a weekly basis during harvest and on a monthly basis thereafter.

There has been major abuse of pool EPRs in the past, with pool providers increasing EPRs during harvest in order to capture volume into the pool. It is done without any analysis of a realistic EPR or if the EPR is achievable. It is purely to “beat’ the competition.

This issue is a major concern to grain producers, and the pool operators who are responsible and honest in their EPR calculations, as it undermines the market and misleads producers. One solution is to force pools to publish the EPR alongside pool equity.

EPRs pool components = pool equity (revenue less costs plus mark to market) plus market view

The variable “market views” is the portion of the equation that can be manipulated to encourage tonnage into a pool.

Hence if the pool provider is also forced to publish pool equity alongside an EPR, it will disclose how much of the EPR is subject to market risk and views.

For the initial first published EPRs prior to pool deliveries, operators should have to publish the current market prices.

GPA Recommendation 9 - Pool providers must include details of related party transactions

Related Party Transactions are a major concern. Concerns centre around Companies cash trading arms buying all or the majority of a pool's tonnage at below market, to then turn it around to 'clip the ticket' on resale.

The current guidelines address related party transactions, requiring that related party transactions need to be reasonable and at arms length.

GPA believes the guidelines need to go further.

If related party transactions are allowed, the PDS must state this and the nature of the allowed transactions including:

- The related parties,
- If it is mandatory for the pool to sell grain to this related party,
- How much of the pool is expected to be sold to this related party, and
- That the pool will not sell to a related party at less than the alternative best market bid on any given day and will have in place processes to ensure this, with proof.

GPA Recommendation 10 - Pool providers must demonstrate separation/ring-fencing of pool management and accounts within related party entities

GPA Recommendation 11 - Pool Providers must clearly identify grain and all transactions belonging to a pool at the time of the transaction.

Similar to related party transactions, pools and their management must be 'ring-fenced' from cash trading operations of the same entity. This is to prevent opportunistic behavior which is detrimental to pool participants, for example, allocation of high priced sales to the cash trading book to earn a higher margin. Alternately lower priced sales are allocated to the pool book at the expense of the Pool Equity.

Concerns primarily centre on the allocation of physical sales, shipping slots and hedges between cash trading arms and pools well after the actual transactions and based upon the performance of that pool.

Section 2 of the Guidelines specifies for clear identification of grain belonging to the pool and separation of pool assets and liabilities from other pools and that of the Pool Provider.

This section of the Guidelines needs to be extended for clarity as recommended and also this separation of assets and liabilities includes separation from the assets and liabilities of the cash-trading arm of a business.

GPA Recommendation 12: Integrity of transaction allocations, assets and liabilities of a pool should form part of the final pool audit and the results published.

Pools are currently audited based on accuracy of costs and revenue attributed to a pool. However, any audit should be extended to confirm that assets, liabilities and contracts have been allocated at time transaction and not subsequently.

GPA Recommendation 13: Material Adverse Changes in relation to an EPR should mean a reduction of the last published EPR of more than 5%.

Section 6.3 of the Guidelines states it is since the “Original” EPR but it should be off the last EPR published.

Further analysis is required to ensure accountability and to provide evidence to support GTAs assertion that the provision of pool services is operating as claimed.

There must be rigor in the process followed by GTA. As noted by the GTA in its call for submissions “with the advantage of self-regulation comes the responsibility for Industry to perform to best practice and operate in an ethical manner.

When researching to make submissions to the WIAT review of grain pools as financial products, GPA member NSW Farmers sought access to materials developed as part of a regulatory analysis; however, such materials were not readily accessible upon request. This means that there are no materials readily available for Government or industry, in particular GTA, to adequately consider the performance or non-compliance with the TGD and Code of Practice.

Conclusion

GPA believes it is time for GTA to ensure all member pool operators take responsibility and be accountable for their product performance to those who are investing in these products. The current lack of consistency and information flow needs to be addressed.

We reiterate our key recommendations:

GPA recommendation 1 – Compulsory Product Disclosure Statement (PDS)

GPA Recommendation 2 - The Operating Standards for Pool Providers technical document should be renamed *Pool Provider Code of Practice*.

GPA recommendation 3 – GTA should set a standardised format for the quoting of Estimated Pool Returns.

GPA Recommendation 4 - The organisations compliance with their PDS should form part of the final pool audit and the results published.

GPA Recommendation 5 - GPA supports stronger action by GTA to annually review and analyse pool provider performance against their PDS.

GPA Recommendation 7 - Pool operators must have appropriate systems, processes, and governance in place to operate Pool

GPA Recommendation 11 - Pool Providers must clearly identify grain and all transactions belonging to a pool at the time of the transaction.

Members of GPA are adamant there needs to be substantial change in the way pools are operated to ensure our concerns surrounding the current pool arrangements are met. We would be available if needed to clarify anything we have raised in this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Andrew N. Weidemann". The signature is fluid and cursive, with a long horizontal stroke at the end.

Andrew Weidemann
Chairman, Grain Producers Australia