SUBMISSION

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Submission on: **Review of the Financial Advisors Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008**

From: Federated Farmers of New Zealand

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SUBMISSION TO THE MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT ON THE REVIEW OF THE FINANCIAL ADVISORS ACT 2008 AND THE FINANCIAL SERVICE PROVIDERS (REGISTRATION AND DISPUTE RESOLUTION) ACT 2008

1. INTRODUCTION

1.1 Federated Farmers welcomes the opportunity to submit to the Ministry of Business, Innovation & Employment on the *Review of the Financial Advisors Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008*.

1.2 Farmers are significant users of financial services, for example banking and insurance, and they hold significant financial investments in dairy and meat processors, fertiliser companies, insurance companies, irrigation schemes, and providers of a range of rural supplies and services. Many of these are cooperatives, businesses owned by farmer shareholders.

1.3 With regard to banking, the sum of agricultural sector credit has exceeded $56 billion and is growing at more than 6 percent per annum. Collectively, farms pay around $3 billion in interest each year, making bank interest the single largest expense for many farms.

1.4 Federated Farmers agrees that consumers of financial services need unbiased, quality financial advice in order to give them confidence to make the most of investment opportunities. This requires a high quality regulatory framework, one that balances the protection of consumer interests with keeping compliance costs at a reasonable level.

1.5 The Financial Advisors Act and the Financial Service Providers (Registration and Dispute Resolution) Act were each passed in 2008. Since then the new regulatory regime has settled down and it has contended with the fall-out from the Global Financial Crisis and, in New Zealand, the collapse of finance companies and issues with interest rate swaps sold to farmers.

1.6 Federated Farmers agrees that it is timely to learn from these experiences and review the legislation to ensure it is still fit for purpose.

1.7 Federated Farmers will mainly comment on issues relating to banking and dispute resolution.

2. SUMMARY OF RECOMMENDATIONS

2.1 Federated Farmers' recommendations to this review are focused on dispute resolution schemes. The Federation recommends that:

(a) The jurisdictional limits on the size of claims that disputes resolution schemes can hear should be raised to at least $500,000

(b) Dispute resolution schemes should be able to consider matters of commercial judgment and interest rate policies

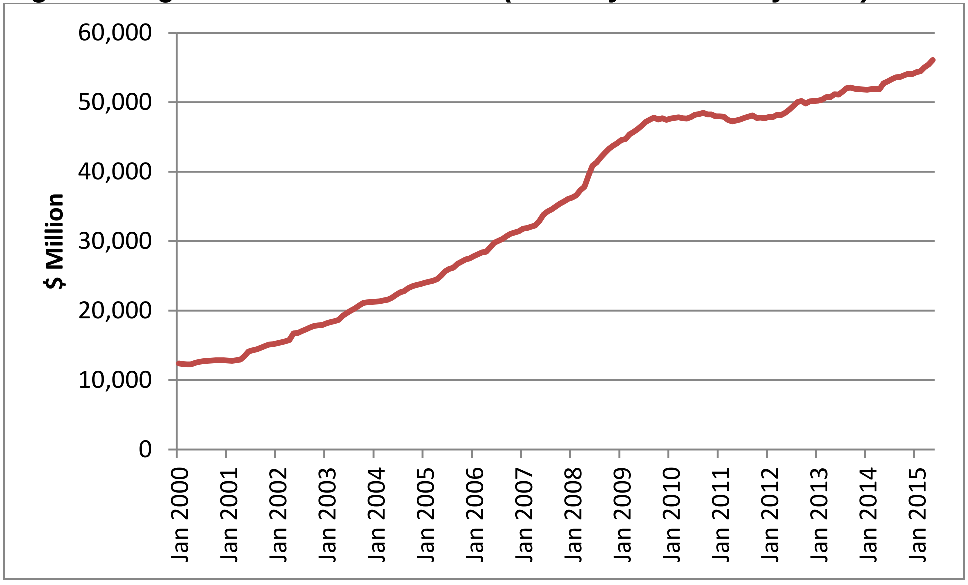
3. BANKING

3.1 Since 2000 farmers have collectively accumulated a large amount of debt, as shown in Figure 1. Agricultural sector debt reached $56.1 billion in May 2015, which compares to $86.2 billion for other businesses and $217.6 billion for households. Agricultural debt is high considering the sector's direct contribution to New Zealand's total GDP is around 5-6 percent[1]. After being relatively stable from 2009 to 2012 agricultural debt is on the rise again and is currently growing at an annual rate of 6.4 percent.

3.2 Much has been written about the nature of farm debt, with around two thirds of total farm debt held by the dairy sector. Furthermore, one third of dairy sector debt is held by 10 percent of dairy farmers, who are considered to be vulnerable to worsening sectoral conditions. The Reserve Bank keeps a close eye on dairy debt and has identified it as being one of three key areas of risk to financial stability (the others being household sector debt and global financial conditions).

3.3 Although there has been a trend towards consolidation and corporatisation of farms, most farms remain family owned and operated. By most definitions the vast majority of farms are small businesses but many have debt levels more akin to medium to large businesses. Banks' decisions can have a huge impact on farm businesses and farming families' economic and social well-being.

Figure 1: Agricultural Sector Credit (January 2000 – May 2015)



3.4 Federated Farmers has consistently advised farmers to make prudent use of debt and that during good times they should seek to reduce their debt. We also recommend farmers keep a close eye on their budgets and keep in contact with their banks and their accountants. This is particularly important during difficult periods, such as the present time, with many farmers struggling in the face of lower farmgate prices for their produce and in some cases adverse weather events imposing additional costs and impacting on farm production.

3.5 Federated Farmers urges farmers to make sure they get independent quality advice when considering financial products and services. At the same time we expect banks and other financial service providers to treat their customers fairly and with respect. We also encourage them during tough times, such as the present time to stand by their customers so that otherwise viable businesses are able to 'get through'. While we believe most farmers are satisfied with their relationships some most definitely are not. This is particularly the case for those burnt by interest rate swaps.

[1] But perhaps not unjustifiably high considering agriculture's contribution to exports, which is above 50 percent.

3.6 The experience some farmers had with interest rate swaps has made many very sceptical about the quality of financial advice they received as well as the motivations of the bank staff selling the products. Anecdotally, it wasn't always clear to the farmer whether the bank staff were acting as advisors or as salespeople.

3.7 While Federated Farmers is a strong believer in individual responsibility, the recent settlements three banks (ANZ, ASB and Westpac) reached with the Commerce Commission indicate that there were serious problems with the selling of what are very complex financial products. Although the conduct of each of the three banks was different, and this was reflected in the settlements reached, the banks were found to have understated some of the risks and/or overstated some of the benefits of interest rate swap arrangements to some of its customers.

3.8 Federated Farmers acknowledges that many of the issues with the selling of swaps would have arisen prior to current regulatory regime, but there are likely to be lessons that should be taken on board for this review. It is notable that despite reaching settlements, the banks did not accept all of the Commission's conclusions. Federated Farmers hopes that lessons have been learnt by the banks.

4. DISPUTE RESOLUTION

4.1 Federated Farmers strongly supports farmers having access to an independent disputes resolution service, such as the Banking Ombudsman Scheme (BOS). This is consistent with the Federation's support for voluntary farm debt mediation.

4.2 Unlike Canada and some Australian states New Zealand does not have legislation mandating farm debt mediation. This makes the BOS an important back-stop for resolving farmer complaints about banks. We have previously commented that an accessible BOS means that a Farm Debt Mediation Act is not as necessary for New Zealand.

4.3 The key here is accessibility and for the BOS to be accessible to farmers there are barriers that need to be addressed. The main barriers are the current financial limit of $200,000 and the exclusion of complaints about a bank's commercial judgment and interest rate policies.

4.4 Federated Farmers submitted last year on the independent review of the BOS, recommending that these barriers be addressed. It was pleasing that the review recommended an increase in the financial limit, noting that similar schemes in other countries can investigate claims above their compensation limit.

4.5 Disappointingly the BOS's Board decided in May 2015 not to proceed with increasing the limit. The main reason given was that increasing the limit would "put the scheme out of step with New Zealand's other financial dispute resolution schemes". It was observed that jurisdictional limits would be considered in the Government's review of the Financial Advisors Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 – i.e., this very review.

4.6 The current BOS financial limit is $200,000 and it has been in place since 2006. The $200,000 limit was justified at that time as 'equating to the upper limit of ordinary home loans'. Federated Farmers believes that with median house prices increasing significantly since 2006, the upper limit for ordinary home loans will now be much higher, especially in markets like Auckland where the median house price reached $749,000 in May 2015 (with the average house price of $885,000)[2]. An Aucklander borrowing 80

[2] Real Estate Institute of New Zealand's monthly Residential Market Reports.

percent of a median house's value will be have a mortgage of $599,000. This is only the median, not an 'upper limit'.

4.7 The Federation also believes that the $200,000 financial limit is becoming increasingly out of touch for farm lending. In February 2006 there were 66,831 agricultural businesses and agricultural sector debt was $28,360 million, making an average debt of $424,000. In February 2014 there were 55,629 agricultural businesses and agricultural sector debt was $51,854 million, meaning that the average debt had more than doubled to $932,000. 2015's count of agricultural business is not due to be released until October, but given that the most recent statistics for agricultural debt has it at $56,074 million and given that a further decline in the number of agricultural businesses seems likely, average debt levels could now be over $1 million[3].

4.8 As mentioned in section 3 of this submission agricultural debt is highly concentrated. Median debt levels for agriculture are therefore likely to be somewhat lower than the average levels, but they will still be considerably higher than either household debt or business debt.

4.9 Federated Farmers also notes that the Australian Financial Services Ombudsman has a financial limit of AUD 500,000. The purpose of its limit is to ensure it is aligned to the point where the price of a financial product is taken out of the 'retail client' arena. Federated Farmers believes that a similar approach in New Zealand would result in a financial limit well in excess of NZD 500,000.

4.10 The financial limit is interpreted to mean a limit on compensation. Banks have suggested to us that even if the loan is for more than $200,000 complaints can be considered by the BOS if the claimed damage is less than $200,000, for example a year's interest on a $1 million loan which might be around $70,000. This may be so, but farmers who feel they have been unjustly 'sold out' due to a bank's action are likely to lose far more than $200,000.

4.11 Federated Farmers understands that a limit is needed to focus the BOS on assisting households and small businesses who do not have the expertise and/or clout that large corporates usually have when dealing with their banks. However, while the amounts many farmers owe their banks are in the corporate league most farms, especially those owned and operated as family farms, are small businesses by any other metric. This means that caution is needed when applying thresholds for 'retail' versus 'wholesale' customers.

4.12 Recommendation: Federated Farmers recommends that the jurisdictional limits on the size of claims that disputes resolution schemes can hear should be raised to at least $500,000.

Commercial Judgment and Interest Rate Policies

4.13 The BOS is also precluded in its terms of reference to consider complaints relating to a participating bank's 'commercial judgment' or its interest rate policies, although as with claims above the financial limit the Scheme can consider these sorts of complaints if the bank in question agrees.

4.14 Federated Farmers is aware of farmers complaining about the way they have been treated by banks in the course of the exercising of their commercial judgment and/or implementing their interest rate policies. This is particularly a problem when there are

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[3] Statistics New Zealand's annual Business Demographic Statistics and Reserve Bank of New Zealand's monthly Sector Credit Statistics.

changes to the underlying criteria behind banks' commercial judgment and interest rate policies.

4.15 For example, after several years of being sold 'easy credit' by their banks, from 2009 farmers came under sudden pressure (sometimes intense pressure) from their banks tightening up on both new and existing lending. Many farmers also faced significantly higher debt servicing costs despite substantial cuts in base lending rates due to the imposition of new or increased margin rates on top of their base lending rates. As discussed earlier in this submission, others had negative experiences around interest rate swaps, which were often sold aggressively by banks and in some cases without either party fully understanding the implications.

4.16 With regard to swaps, a number of farmers received settlements from their banks where it was acknowledged that there may have been mis-selling of swaps. Swaps sold to farmers were also the subject of a Commerce Commission investigation and further settlements being awarded. It could be argued therefore that the current system is working, albeit slowly, and there is no need for the BOS to intervene.

4.17 However, Federated Farmers believes that if the BOS had been able to consider these sorts of complaints they might have been resolved much more quickly. Knowing that they could be taken to the BOS might also have provided banks with a greater incentive during the loose lending periods to have better systems in place that might have prevented the problems that did arise.

4.18 The strictly conservative lending environment that was abruptly imposed on farmers following the Global Financial Crisis appears to have been short-lived, with evidence that banks have been in 'sales mode'. Agricultural land prices are on the rise as is agricultural debt, despite falls in commodity prices, especially for dairy products. Federated Farmers would be concerned if pre-Global Financial Crisis behaviours were to become imbedded again and this means that mechanisms need to be in place to address problems should there be another sudden reversal in bank lending policy.

4.19 It is important to recognise that unlike Canada and some Australian states New Zealand does not have a Farm Debt Mediation Act which would cover disputes around a bank's commercial judgment and its interest rate policies. Federated Farmers does not favour such an Act for New Zealand because we believe that voluntary mediation backed up by the BOS is the better way to go. However, this is subject to ensuring that barriers to accessibility are removed and this review is a good opportunity to achieve this.

4.20 Recommendation: Federated Farmers recommends that dispute resolution schemes should be able to consider matters of commercial judgment and interest rate policies

5. ANSWERS TO KEY QUESTIONS

5.1 The following provides answers to the 11 key questions set out in the discussion paper.

Regulation of Financial Advice

<u>Goal 1: Consumers have the information they need to find and choose a financial advisor</u>

5.2 Question 1: Do consumers understand the complexities of the regulatory framework?
Understanding of the regulatory framework is likely to be patchy, especially for SME customers of financial service providers. As mentioned above many farms with large amounts of debt will be SMEs by any other metric and will not have the in-house

expertise of larger corporates. They rely on advice from outside professionals, often working for financial services providers.

5.3 Question 2: Should there be a clearer distinction between advice and sales?
Lack of clarity between advice and sales was a common concern of farmers who believed they had been mis-sold interest rate swaps. We acknowledge though that many of the cases of mis-selling appear to have originated prior to the 2008 legislation entering into force. We are not aware of more recent problems, perhaps because of greater knowledge and understanding of swaps and other 'innovative' products or perhaps because the Financial Advisors Act is working.

5.4 Question 3: How should we regulate commissions and other conflicts of interest?
Commissions can create a conflict of interest, especially if they incentivise an advisor to advise their client to buy a particular product. This concern was raised by some farmers who believed they were mis-sold interest rate swaps. We acknowledge that many of the cases of mis-selling appear to have originated prior to the 2008 legislation entering into force.

We are not aware of problems arising more recently, perhaps because of greater knowledge and understanding of swaps and other 'innovative' products, perhaps because providers have moved away from commission remuneration, or perhaps because the Financial Advisors Act's disclosure regime is working.

Currently the regulatory approach is for disclosure rather than prohibition. Whether to impose further restrictions or prohibitions on commissions would need careful consideration.

<u>Goal 2: Financial advice is accessible for consumers</u>

5.5 Question 4: Does the Financial Advisors Act unduly restrict access to financial advice?
Any regulation of financial advice which seeks to exclude people that do not meet standards of knowledge or behaviour and which imposes compliance costs on providers will not only restrict the supply of financial advice but also increase the cost of that advice to the consumer. However, if the alternative to that regulation is a proliferation of incompetent or unscrupulous financial advisors who impose significant costs on consumers and the economy then that restriction of access to financial advice might be worthwhile. A robust cost-benefit analysis should be undertaken.

5.6 Question 5: How can compliance costs be reduced under the current regime without limiting access to quality financial advice?
Compliance costs can be minimised by ensuring that regulation is targeted at protecting those consumers that need protection. These will largely be retail consumers. Wholesale consumers should have the knowledge and systems in place to make informed decisions, although we note that the thresholds for retail versus wholesale need to recognise that some people (such as many farmers) with 'corporate sized' debt will be SMEs by any other metric.

5.7 Question 6: How can we facilitate access to advice in the future?
Flexibility of the regulatory regime will be very important. It is certain that the landscape for financial services will change and change rapidly. Demographic change (e.g., ageing population, ethnic/cultural diversity, etc.) will impact on the types of products and services demanded while the evolution of technology (e.g., on-line platforms) will make it easier for New Zealanders to access products in a global market. The financial services industry is highly innovative and is likely to develop products that might not be envisaged today. The regulation of financial services needs to cater for these factors and be flexible enough so it does not put in place barriers to the development and dissemination of products that would benefit consumers and the economy as a whole. .

Goal 3: Public confidence in the professionalism of financial advisers

5.8 Question 7: Should we lift the professional, ethical and educational standards for financial advisers?
It is important for financial advisers to meet high standards. However, we do not feel well qualified to speculate on whether standards for different types of advisers need to be aligned and/or increased.

5.9 Question 8: Should the individual adviser or the business hold obligations?
Given that in many cases financial advisors are working directly for businesses (such as banks) and are subject to their policies and practices it seems appropriate for both to face obligations and the Financial Advisors Act takes a mixed approach. However, we do not feel well qualified to comment on whether this approach is working or could be improved.

Financial Service Provider Registration and Dispute Resolution

5.10 Question 9: Could the Register provide better information to the public?
We agree with the discussion paper that register information should be useful (i.e., meet the needs of users), accurate, and accessible. However, we do not feel well qualified to speculate on whether the information in the Register meets these goals. We suspect that consumer knowledge of the Register (let alone use of it) is unlikely to be widespread and this might mean it needs to be better promoted.

5.11 Question 10: How can we avoid misuse of the Register by overseas financial service providers?
It is important to ensure that misuse of the Register is prevented, whether it is by New Zealanders or by overseas persons. However, we do not feel well qualified to speculate on what specific measures could be taken.

5.12 Question 11: What is the impact of having multiple dispute resolution schemes?
There are four approved dispute resolution schemes, each of which has a particular focus. We do not have a view on whether the schemes should be rationalised; that will depend on whether there are overlaps, duplications or contradictions between the schemes.

From a consumer perspective it is important that the schemes are each accessible, independent, fair, accountable, efficient, and effective (i.e., consistent with the well-established principles for dispute resolution). If the landscape of dispute resolution schemes is to be reviewed then it should be reviewed against these goals.

As mentioned previously in this submission Federated Farmers believes that there are strong grounds to significantly raise the thresholds for considering claims – currently $200,000 across the four schemes. We believe the threshold should be raised to at least $500,000.

6. ABOUT FEDERATED FARMERS

6.1 Federated Farmers of New Zealand is a member-based organisation representing farming and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand farmers.

6.2 The Federation aims to add value to its members' farming business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;

- Our members' families and their staff have access to services essential to the needs of the rural community; and

- Our members adopt responsible management and environmental practices.