

12<sup>th</sup> September 2016

Mai Go  
Lawyer, Investment Managers & Superannuation  
Australian Securities and Investments Commission  
Level 7, 120 Collins Street  
MELBOURNE VICTORIA 3000

Email: mai.go@asic.gov.au

Dear Ms Go,

**Re: Consultation Paper 266: Remaking ASIC class orders on managed investment schemes: not for money.**

Please find following a submission from Grain Producers SA Ltd (GPSA) regarding ASIC's proposal to remake the class order [CO 02/211] Managed investment schemes: Interests not for money, which is due to expire in April 2017.

GPSA thanks ASIC for the opportunity to make this submission and would welcome an opportunity to meet with you to discuss this submission or answer any specific questions or concerns.

Yours sincerely



Darren Arney  
Chief Executive Officer

## About Grain Producers SA

Grain Producers SA (GPSA) is the peak industry body representing South Australian grain producers.

South Australia's grain industries are large and diverse, making a significant contribution to the economy. With an estimated farm gate value of over \$1.8 billion and export value of \$2.2 billion, the grains industry is not only a major contributor to the economy it is also a significant export earner. In addition, the agribusiness sector is a major provider of jobs employing approximately 1 in 5 South Australian workers.

GPSA's objectives are to improve the profitability and sustainability of South Australian grain producers through:

- Representing the views of South Australian grain producers to government, industry and the community on grains issues;
- Working with an effective state farming organisation and other commodity groups to represent South Australian grain producers on cross commodity issues;
- Working with government and industry to develop policies around creating and maintaining an efficient, accessible and cost effective supply chain;
- Working with government, industry and institutions to improve the technical and business skills of South Australian grain producers
- Working with Research, Development and Extension organisations to identify and disseminate research priorities in grain production, handling and management
- Supporting an effective national representative organisation to work with government around national initiatives to support the grains industry
- Providing a program to include and develop young farmers to be prepared to take on leadership roles within the SA grains industry.

## Background

In the 2010/11 grain marketing season, South Australian grain producers suffered significant losses due to the alleged misconduct of a grain pool operator. On seeking recourse from ASIC, GPSA was advised that wheat pools remain outside of ASIC's jurisdiction due to the class order [CO 02/211] *Managed Investment Schemes: interests not for money*. This class action is due to expire in April 2017 unless ASIC reinstates it.

In August 2016 ASIC announced the opening of its consultation period to consider the relaxation of the class order. It should be noted that the advertisement of this consultation period was not effective in reaching the grain industry. GPSA along with other farming organisations, grain traders and grain brokers only became aware of this important industry consultation period in the first week of September despite the consultation period commencing on 10 August.

GPSA welcomes the opportunity to make a submission on behalf of South Australian grain producers on this important issue.

## Current Situation

Grain pools are similar to managed funds and property trusts. They allow grain growers to combine (or pool) their grain with other growers' grain to form larger marketable parcels. They are one of a number of marketing options available to Australian growers to sell their grain. A number of companies in Australia offer grain pools and the offering varies widely from large corporates to smaller boutique traders.

Grain pools operate by having growers commit a certain tonnage of grain to a pool to be marketed by the relevant trader over a period of time. The grower will expect that the trader will use their skill, market access and financing to provide a favourable dollar per tonne return to the grower.

Grain pools are generally considered to be managed investment schemes. Such schemes attract a number of compliance requirements under the Corporation Act 2001, including the requirement for the scheme operator to hold an AFS licence.

However, for the past 10 years, ASIC has granted relief to grain pool operators through class order 02/212. This order is a relief order granted by ASIC to exempt operators of grain pools from managed investment scheme provisions of the *Corporations Act 2001*.

The class order in question gives relief to grain pool operations of the following provisions of the Act:

- the requirement to register the scheme with ASIC,
- the requirement for a person to hold an AFS license,
- the prohibition of hawking
- the obligation to provide a product disclosure statement.

GPSA acknowledges that Grain Trade Australia implemented the Australian Grain Industry – Code of Practice Technical Guideline Document No.4 Operating Standards for Pool Providers in July 2013. GTA members are required to adhere to the standard of the Code when offering grain pool products to their clients. This code provides guidance to grain growers who are considering entering into a grain pool agreement and also provides a list of duties that grain pool providers must adhere to.

Whilst GPSA agrees with the principals and intentions of the code, the penalties for breaching the code are not adequate deterrents for the types of misconduct evident in the industry. The Code as a standalone measure is not strong enough to deliver the appropriate oversight, scrutiny and reporting on the performance of marketing pools in accordance with their nature as a financial product.

### **Estimated Pool Returns**

Wheat Exports Australia commissioned a report by PwC entitled *Analysis for Growers. Estimated Pool Returns: the Relationship to Final Price*. The report outlines that estimated pool returns are not a trustworthy predictor of the final pool return. This leaves farmers in an unacceptable position in which a false market signal is given in relation to the marketing options available and there many examples where grain marketing pools have substantially underperformed against their estimated pool returns.

An illustration of poor performance of a pool in operation during the 2011/12 season is illustrated below:

	<b>AWB SA Pool</b>	<b>Emerald Traditional Pool</b>	<b>Emerald Dynamic Pool</b>
Final Pool Return APW1 wheat	\$ 267.20	\$ 236.00	\$ 264.00
FOBing Costs	\$ 46.00	\$ 57.00	\$ 57.00
Early Commitment AWB	\$ 15.00		
Early commitment Emerald		\$20 included	\$20 included
AWB Golden Rewards (average)	\$ 6.50		
Emerald Quality Rewards		included	included
	<b>\$ 242.70</b>	<b>\$ 179.00</b>	<b>\$ 207.00</b>
Finance costs (Emerald Assumed)	\$ 11.99	\$ 12.00	\$ 12.00
<b>Estimated Silo Return Pt. Adelaide</b>	<b>\$ 230.71</b>	<b>\$ 167.00</b>	<b>\$ 195.00</b>
<b>ESR for growers with no EOP</b>	<b>\$ 215.71</b>	<b>\$ 147.00</b>	<b>\$ 175.00</b>

FOB costs for Port Adelaide have been quoted. Note AWB's FOB cost for Port Lincoln of \$43.99 is \$2.01 better than Port Adelaide.

Emerald stated at the time that its Dynamic Pool was the headline pool however the vast majority of growers had wheat in the Traditional Pool.

GPSA believes that it is unreasonable for growers to expect to receive \$147 ESR Port Adelaide when the average APW1 price (flat / no rewards) was \$214.36. It should also be noted that during the period 2011 to 2013, APW1 wheat on NSW futures rarely traded below \$200 – well above the average price of \$147 achieved through the Emerald Traditional Pool.

#### **Quoting FOB pricing**

Another issue with the current operation of pools is the estimated pricing used. Pool operators quote Free on Board (FOB) pricing versus cash pricing. Pools are estimated on the ship side of the grain terminal (Free On Board or FOB) whereas cash prices are advertised on the inward side of the grain terminal (delivered port). This can be confusing to grain producers, indicating a higher price in the pool relative to a cash price for the same return.

An example of FOB pricing compared to cash pricing is as follows:

- **FOB Price APW1** **\$328.00**
- Less Fobbing adjustment Pt Lincoln (\$40.79)
- Less Finance cost (\$19.42)
- Less underwriting (\$2.50)
- Add on quality rewards for protein 11% \$11.50  
Screenings 3%, moisture 11% and test weight of 78kg/hl
- **Equals Cash Equivalent of** **\$276.79**

In summary, \$328 vs \$276.79 for the same wheat is clearly a misleading way of representing prices. Grain producers looking at the above scenario would think the pool price of \$328 is far better than the cash price of \$276.79 even though they work out the same. The other important difference to note is the cash price is fixed but the pool price is only an estimate until finalised – and as illustrated above, estimated pool returns are not a trustworthy predictor of the final pool return.

### **Use of complex derivative strategies without appropriate risk statements**

Because pool operators are not required to operate under an AFS Licence, there is no regulation around what strategies they can adopt to generate their final pool return. In some cases pool operators adopt complex derivative strategies without being required to provide the appropriate risk statements to grain producers utilising the pool. This leaves grain producers highly exposed to risk that they are largely unaware of which is an unacceptable position.

### **Non disclosed trailing commissions**

Another requirement of operating under an AFS License is the disclosure of trailing commissions. The class order allows pool operators to offer trailing commissions with no obligation to disclose these arrangements. This can lead to conflicts of interest and a non-transparent, unfair market

Removal of the class order would enable the establishment of appropriate oversight, scrutiny and reporting on the performance of marketing pools in accordance with their nature as a financial product and provide much needed clarity for grain producers on the products offered for the sale of grain.

### **Recommendation**

GPSA believes that ASIC **should not** remake the legislative instrument – class order [CO 02/211] *Managed investment schemes: Interests not for money*, which is due to expire in April 2017.

If this instrument were to be remade, GPSA believes that the financial impact on grain producers using grain pools as a financial product is significant and ASIC's priorities of promoting investor and financial consumer trust and confidence and ensuring markets are fair, orderly and transparent will not be met.

Further to this, GPSA opposes ASIC's proposal to combine CO 02/210, CO02/211 and CO02/236 into one instrument. There is logic to combining CO 02/210 and CO 02/236 as these instruments both relate to the Australian Film industry. CO 02/211 should be separated from the other instruments and should not be remade.

It should also be noted that many companies, both large and small operate successfully under an AFS licence and can meet the obligations of the Corporations Act without issues. The argument that relaxing the class order will add significant cost to pool operators which may in turn be passed on to growers, or may result in a reduction of pool products on offer is weak. If this was to occur growers can choose to opt in or out of the pool with at least having some peace of mind that the product they are choosing is sound and has some regulation around it.

### **Benefits of removing the class order**

As stated in the Wheat Industry Advisory Taskforce's final report on Grain pools as financial products, the benefits in removing the class order include:

- A product disclosure statement would be required to be produced prior to a grain producer electing to contract or deliver to a pool.
- Ring-fencing of assets and separate financial reporting on a regular basis is published to pool participants and available for ASIC to review as necessary.
- A requirement for a constitution and appropriate independent governance, at arm's-length to other proprietary commodity trading activities of a pool provider, and documentation of decisions.
- Regular reporting of performance
- A recognised and effective dispute resolution mechanism is mandatory
- Breaches are dealt with by an independent regulator under the Corporations Act 2001.