

17 February 2015

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

Financial Markets Policy

MBIE

P O Box 3705

Wellington.

My submission is intended to place the issue of fairness to borrowers formally as a matter for consideration by this process.

This submission is a collection of thoughts, regrettably I lack the time to improve the presentation of this material. Thank you for your understanding on this point.

Due to client confidentiality concerns I am not able to provide multiple examples of actual incidents but I would suggest that some research could be conducted including looking at the historical rulings of the Banking Ombudsman's office.

Financial service providers need to be fair to borrowers as well as to investors investing funds with financial institutions.

Unfair treatment of borrowers, given New Zealand's quantum of borrowed funds is probably at least as important to wealth preservation and growth within the nation , as protection of investors.

Lending managers can easily find themselves in positions where they are both selling a product and providing advice, particularly in the area of rural banking where many bankers hold qualifications pertaining to the rural sector.

Such bankers, charged by their employers (as they are) with maximizing the return they obtain on the portfolio of capital they are lending / managing, face a major conflict of interest and lack even a basic formalised code of ethics. A code of ethics would be useful both in providing ethical guidance, and in assisting bank staff to push back against excessive pressure to maximise profits, usually from the vulnerable or naive. As the sums required to operate farming business trend now into the millions, more transparency and higher levels of confidence are surely required.

It must be acknowledged that farmers seem particularly at risk of both personal and financial tragedy when things go wrong for them. If it is accepted that banks expect the maximum return from any "lending book" , it seems logical that the farmers most exposed to upward pressure on their interest rate margins are those in the most vulnerable positions.

Farmers with the strongest balance sheets after all can quite easily change banks. The most vulnerable farmers are less likely to be able to change banks during a crisis / adverse event.

I would suggest therefore that today's technology ought now to be able to ensure that borrowers are formally put on notice what their credit status is , what factors might trigger a movement in their status and the likely extent of any movement in interest rate margins. Ideally, a period of grace during which they would have time to restore their credit rating might also be negotiated in advance with their bank. This may take the form of an insurance policy.

I acknowledge that as in any occupation , there are people who behave well and those who do not. My concern is that protections be put in place for borrowers, against banks or bank lending managers who are motivated to charge excessively high rates of interest.

Consumers Access to Advice & Assistance

It should be noted that, in the same way banks now select which valuers they will deal with, it may not be long before other professions charged with supporting the rural sector, also find themselves discouraged from robustly challenging unethical bank behaviour for fear of discrimination etc.

Consumers access to effective redress & support.

As commented earlier it seems to me that many farmers will find that when they need it, inadequate support is available to help them battle unfair lender behaviour.

I have seen recently, a farmer treated unethically by a bank (in my opinion) , seek and be refused, support from his rural solicitor. The sums involved and the loss to the client by now well exceed the \$200,000 compensation maximum available from the ombudsman and yet to challenge the bank it would seem to be necessary for the client to seek out a metropolitan barrister or QC at a cost of \$600-\$900 per hour to look into the case. These battling farmers simply cannot afford to employ this legal support, even if the funds to pay them were accessible , bearing in mind that the financier approves expenditure in many cases, ie , where do the funds come from to fund legal assistance ?

I do not wish to speculate on the reasons that some farm support / providers or professionals may less robust than they might otherwise be in challenging some bank behaviour , but it may well be that some have made debt funded investments and feel wary of upsetting lending institutions.

Banking Ombudsman's Powers.

I note that recently, the advice of the banking ombudsman to her minister/& board, was that \$200,000 was an adequate limit even though federated farmers submitted to the banking ombudsman that the limit should be increased.

I would further surmise that as the banking ombudsman is allowed only to become involved in cases where agreement is not reached between bank and client – the information technically available to the ombudsman is likely to be either

- a. Not available to the ombudsman due to confidentially clauses
- b. Or to some extent – delayed (sometimes for significant periods). Meaning that there is at times a delay between current banking practice and what the office of the banking ombudsman is aware of. In this I cite the example of the length of time it took for the Banking Ombudsman's office to publicly acknowledge the problem with Bank Swaps.

Advice Improves Consumers Financial Outcomes

Transparency : & Credit Rating

>>>>>> = Cost of Funds Rating

= Rating factors and frankly discussed contingency factors and time to remedy in the event that an adverse event occurs , ie drought , commodity price downturn. Given the superior expertise available to banks who are massively better resourced in terms of Economists – Farming Experts & Valuation Data than any other farmer or farm support specialist. Clients should have right of access to bank information as this data pertains to them (ie personal file) including where they sit on a risk matrix factor determining margins/interest rates payable over eg the 90 day rate/OCR and what would cause movements in bank risk perception & therefore cause +ive or –ive movement in the interest rate being paid relative to OCR or the borrower’s status quo.

Given the power of banking software and frequency of bank customer reviews I see no reason that key information about clients and where they sit on a risk matrix should be withheld by banks. I agree that bankers significantly remunerated by a bonus structure and closely monitored by bank systems must struggle to maintain an ethical stance and they most certainly face a conflict of interest in their daily roles. Furthermore interactions between bankers and clients are often verbal and too often, one on one, meaning that there are no 3rd party witnesses available.

In my experience , banks tend not to be clear with clients where they sit on a risk assessment matrix and certainly information on what would affect the borrower’s risk assessment & therefore interest rate margin is not volunteered by the banks.

A national database for eg farmers on farm borrowing costs would enable a farmer to establish whether or not they are paying a fair interest rate given their key data. This would take a form similar to the Powerswitch service enabling consumers to compare power prices.

I find it hard to believe that banks would happily contemplate an environment in which bankers are expected to put clients interests first (indeed this would imperil the banks) ; at best therefore , – to protect both parties, banks must be required to demonstrate that their policies at least treat bank & client fairly & transparently.

On the matter of accessing quality information and having the hugely necessary confidence that they are being treated fairly, surely this can best be achieved by requiring adequate access to bankers files and a nationally actually produced database for borrowers. **It must be very debilitating for “ otherwise isolated “ and stressed farmers not to know whether the interest rate they are contending with, is actually fair.**

Discreet Elements – Options for change:

4.2 Advice through technological channels

- Database benchmarking interest rates

4.3 Ethical & Client Case Obligations

Banks fail on all elements. Page 20

Adopt all 3 elements

4.4 Agree

4.5 Agree Registration + Industry Regulation

4.6 Adequate Disclosure of Information

See Questions 3, 4 & 5 page 20

Technological Channel : Individual status advice resolved by designing & requiring regular bank reports to clients on their history, current & projected status.

Financial terms data base and Benchmarking Service

Conflicted/bonus remuneration should be banned or severely restricted in the banking sector.

New Zealand is particularly at risk given the dominance in our banking sector of overseas owned banks.

Competency of Bankers is primarily a matter for banks to determine.

If bank lending managers continue to receive conflicted remuneration – the basis for & extent of should be disclosed in writing annually to each client. Farmers are historically “straight up” and trusting people generally. It seems to me that at times there are few limits or niceties around what certain banks will do to increase their profits, no doubt influenced by the culture / leadership dominating any given bank at any particular time. There can be no doubt that certain classes of bank clients are more vulnerable than others, these people in my view do require improved protection measures.

Scaling of dispute Resolution Sum to dollars borrowed ie \$200 k upwards. ie, should not the sum the banking ombudsman can award be scaled upwards beyond a certain level of borrowing ?

Register of complaints against individual bankers and their bank employers ?

Stephen Lace & Associates Limited

Chartered Accountants

Wanganui