

**ASB BANK LIMITED; AND
THE FINANCIAL MARKETS AUTHORITY**

**SETTLEMENT AGREEMENT REGARDING INTEREST RATE SWAPS SALES from
2005 to 2009**

June 2015

AGREEMENT DATED THIS day of June 2015

PARTIES

This deed is entered into:

BETWEEN **ASB BANK LIMITED (ASB)**

AND the **FINANCIAL MARKETS AUTHORITY**, an independent Crown entity established under section 6 of the Financial Markets Authority Act 2011 (the *FMA*)

(together *the parties*).

1 RECITALS

1.1 The New Zealand Commerce Commission (*the Commerce Commission*) has investigated alleged contraventions of the Fair Trading Act 1986 by ASB in relation to the marketing, promotion and sale of interest rate swaps to rural customers from 2005 to 2009 (*the Commerce Commission Investigation*).

1.2 Based on the FMA's understanding of the results of the Commerce Commission Investigation, the FMA has concerns regarding the marketing, promotion and sale of Interest Rate Swaps to rural customers from 2005 to 2009.

1.3 In particular, the FMA has concerns regarding ASB's conduct in relation to potential contraventions of the Legislation (defined below).

1.4 ASB does not accept that the FMA has grounds for its concerns or that its conduct potentially contravenes the Legislation in the event that the Legislation is applicable.

1.5 ASB and the Commerce Commission have now agreed the means by which the Commerce Commission Investigation is to be resolved and recorded those terms in a settlement agreement dated 23 December 2014 (*the Commission Settlement Agreement*).

1.6 In light of the Commission Settlement Agreement, the FMA and ASB have agreed the means by which the FMA's concerns are to be resolved as recorded in this agreement (*the Agreement*).

1.7 Under the terms of the Commission Settlement Agreement, ASB has agreed to make available for payment a sum expected to be \$2,337,536 to Named Customers and/or Named Customer Entities. ASB has also agreed that it will pay the sum of \$250,000 to the Dairy Women's Network and \$250,000 to the Commerce Commission as a contribution to its costs of the Commerce Commission Investigation.

2 **INTERPRETATION**

2.1 For the purposes of this Agreement:

2.1.1 *"Break cost"* means the amount that is the cost (or in some cases a benefit) to a party to terminate an Interest Rate Swap prior to its maturity date.

2.1.2 *"Interest Rate Swaps"* comprise, in the case of interest rate swaps sold to rural customers, contracts under which one party agrees to make payments based on a fixed interest rate on a notional principal amount, in exchange for receiving payments from the other party based on a floating interest rate on the notional principal amount. The principal amount is not exchanged.

2.1.3 *"Legislation"* means, as applicable, the Securities Act 1978 and the Securities Markets Act 1988.

2.1.4 *"Loan"* means the facility(s) provided by ASB to the Named Customer – usually at a floating interest rate – that corresponds to the Interest Rate Swap(s).

2.1.5 *"Named Customer"* and *"Named Customer Entity"* have the meanings defined in the Commission Settlement Agreement.

2.1.6 *"Related Parties"* of ASB include:

- (a) its past and present directors, officers, employees and agents; and
- (b) its related companies and each related company's past and present directors, officers, employees and agents, where *"related company"* has the same meaning as in the Companies Act 1993.

3 BACKGROUND FACTS

3.1 Between 2005 and 2009, ASB marketed Interest Rate Swaps to existing and potential rural customers, primarily through private meetings conducted with those customers by ASB's rural managers and dealers from ASB's Treasury Department. This marketing included documents and PowerPoint presentations provided to the customers. Interest Rate Swaps were generally sold as a new product in the rural sector at this point in time].

3.2 THE FMA'S CONCERNS ARISING FROM THE COMMERCE COMMISSION INVESTIGATION

3.2.1 In 2012, media reports emerged indicating that certain rural customers were dissatisfied with Interest Rate Swaps.

3.2.2 The Commerce Commission received complaints about the manner in which ASB sold and marketed Interest Rate Swaps to rural customers between 2005 and 2009. In August 2012, the Commerce Commission commenced the Commerce Commission Investigation.

3.2.3 In November 2013, the Commerce Commission contacted the FMA in relation to the Commerce Commission Investigation and to ASB's potential liability under the Legislation.

3.2.4 As a result of the Commerce Commission Investigation, the FMA considered the material provided to it by the Commerce Commission about the way in which Interest Rate Swaps were marketed and transacted by ASB to rural customers between 2005 and 2009 (the *FMA's enquiries*).

3.3 THE FMA'S CONCERNS

3.3.1 The FMA's enquiries have led to concerns that ASB's conduct relating to the marketing and sales of Interest Rate Swaps to certain rural customers may have been misleading on the basis of the Commerce Commission Investigation's conclusions that:

- (a) with respect to Margins, under the contractual terms ASB could increase Margins;
- (b) with respect to termination, the Break Cost could be significantly higher than was anticipated, such as to make it uneconomic to terminate the Swap;
- (c) with respect to suitability, Named Customers could not take advantage of the flexibility of the Swaps because:
 - (i) doing so attracted a Break Cost (as referred to at clause (b) above) of an amount that was not foreseen by some Named Customers, which undermined the

flexibility of the swap and dissuaded some Named Customers from exercising that option; and

- (ii) the Named Customers were not technically equipped to monitor and adjust the swaps.

3.3.2 In addition, the Commission concluded, among other things, that:

- (a) the fact that ASB's own Loan documents provided for it to change Margins indicated that it ought to have contemplated that Margins could or might change;
- (b) based on historical experience, ASB should have foreseen the risk that a material difference between the cost to break a Swap and an equivalent fixed rate term loan could occur as it did in the Global Financial Crisis (GFC); and
- (c) it is likely that some ASB rural customers, including the Named Customers, suffered loss as a result of the Conduct.

3.4 The FMA acknowledges that its concerns and the Commerce Commission's conclusions have not been tested in court.

4 ASB'S POSITION

4.1 ASB does not accept the Commerce Commission's conclusions. In particular, ASB says:

4.1.1 Its description of the effect of Swaps as "similar to a fixed rate term loan but more flexible" was a reasonable opinion based on the bank's experience of market conditions prior to the GFC;

4.1.2 It provided comprehensive information to customers regarding Swaps, which clearly explained their effect and the risks associated with the product;

4.1.3 It sought to ensure that Swaps were fully explained to its customers in one-on-one meetings with an ASB representative so that it could be satisfied that the customer understood the product and that it was suitable for their circumstances;

4.1.4 It recommended that its customers take independent advice before entering into Swaps and some customers, including some Named Customers, did so;

4.1.5 Its managers expected at the time ASB sold Swaps to customers that Margins would not increase as margins on rural floating rate loans had been decreasing for over 20 years;

- 4.1.6 The terms of its Loan agreements provided for Margin changes and many rural swap customers had used these terms to negotiate lower Margins through the period prior to the GFC;
- 4.1.7 It made a decision not to, and did not, increase Margins under Loans hedged by Swaps entered into prior to May 2008 for the duration of the original term of the Swaps (save for a small number of administrative errors that were corrected);
- 4.1.8 Until the onset of the GFC, Break Costs on Swaps were similar to the Break Cost of a fixed rate loan of a similar term and value. The emergence of a differential between the Break Costs on a Swap and the Break Costs on a fixed rate term loan of a similar term and value arose from the extraordinary, unforeseeable effect of the GFC;
- 4.1.9 Any representations made when marketing interest rate Swaps were not the sole cause of the Named Customers deciding to enter Swaps and, in most cases, the Named Customers would have entered into their swap arrangements with ASB regardless of ASB's conduct for reasons including the fact that Swaps provided the customers with improved flexibility and control over the customer's cash flow at a time when the market and the customer anticipated that there would be rising interest rates for the foreseeable future; and
- 4.2 None of its customers suffered, or are likely to have suffered, any loss from its conduct.
- 4.3 ASB also does not accept that any proceedings under the Legislation would necessarily succeed, or that fines, penalties, refunds or damages would be payable at law, whether under the Legislation or any other legislation, regulation or rule of law.

5 TERMS OF SETTLEMENT

- 5.1 Notwithstanding the parties' views, ASB and the FMA have agreed to resolve the issues arising out of the FMA's enquiries and the Commerce Commission Investigation on the terms set out below.

5.2 ASB OBLIGATIONS

- 5.2.1 ASB will appoint an independent party to review the marketing, promotion and sale of the Agreed Products as set out in the **Schedule** (the *Review*).
- 5.2.2 For the avoidance of doubt the Review is conducted without prejudice to whether the Agreed Products and any communications concerning the Agreed Products are subject to the Legislation.
- 5.3 ASB will comply with its obligations to offer to make payments to the Named Customers and/or Named Customer Entities as set out in clauses 3.6 and 3.10 and Schedule One of the Commission Settlement Agreement.

5.4 **NO FURTHER ACTION BY THE FMA**

5.4.1 Upon the execution of this agreement, the FMA enquiries will cease.

5.4.2 The FMA undertakes not to issue, encourage or support any civil or criminal legal proceedings against ASB and/or each of its Related Parties in respect of matters that are the subject of the FMA's enquiries.

5.4.3 The parties agree that this Agreement is in full and final settlement of all claims and proceedings that the FMA has, or may have, whether in its own right or on behalf of any other person, in respect of the matters the subject of the FMA's enquiries howsoever arising.

6 **MISCELLANEOUS**

6.1.1 The FMA acknowledges that the matters covered by the Review and any recommendations arising from the review are confidential and/or commercially sensitive and/or may be subject to privilege (the Confidential ASB Information).

6.1.2 The FMA agrees that, if it receives a request pursuant to the Official Information Act 1982 that covers or might cover and/or record or reveal all or some of the Confidential ASB Information (an Information Request), it will notify ASB of that request and will consult with ASB as to whether there are grounds for the requested material to be withheld under Part 1 of the Official Information Act 1982. The FMA will:

- (a) take full and proper account of the confidential and/or commercially sensitive and/or privileged nature of the Confidential ASB Information, and of any views expressed by ASB, in accordance with the provisions of the Official Information Act 1982 when considering any Information Request; and
- (b) notify ASB at least 5 days prior to complying with the request if, notwithstanding such consideration, the FMA determines that no grounds exist on which it may refuse to comply with the Information Request.

6.2 Any notice or communication that is given or served under or in connection with this Agreement must be given in writing in the following manner:

- (a) If addressed to the FMA, by hand delivery or email to the following address:

The Financial Markets Authority
Attention: Rob Everett, CEO

Email: rob.everett@fma.govt.nz

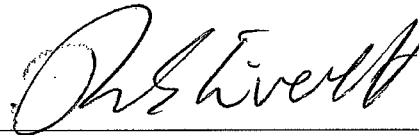
(b) If addressed to ASB, by hand delivery or email to the following address:

ASB Bank Limited

Attention: Graeme Edwards, General Counsel

Email: graeme.edwards@asb.co.nz

**Signed by and on behalf of Financial Markets
Authority**



Authorised signatory



Name

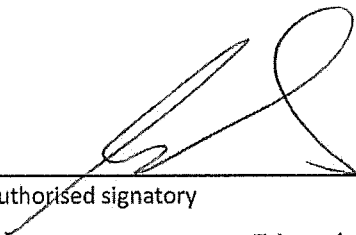
In the presence of:

Witness Name: CAROLINE CAMPBELL

Witness Address: AUCKLAND

Witness Occupation: EXECUTIVE ASSISTANT


Signed by and on behalf of ASB BANK LIMITED by its authorised signatory



Authorised signatory

Graeme Edwards
General Counsel &
Company Secretary
ASB Bank Limited

Name

In the presence of: 

Witness Name: Angela Harvey

Witness Address: ASB Bank, Auckland
North Wharf

Witness Occupation: Executive Assistant

SCHEDULE

ASB's review obligations in relation to financial products

- 1 ASB Bank Limited (ASB) agree to engage an external party acceptable to the Financial Markets Authority (the FMA) to conduct a Review and report as to whether ASB has processes and procedures in place which are appropriate to minimise the risk of it making false, misleading or deceptive representations in relation to the marketing, promotion and sale of the Agreed Products.
- 2 Where possible, the Review will take a sample of ASB's actual practices and provide conclusions as to whether those practices are consistent with ASB's current, approved processes and procedures.
- 3 If the independent reviewer concludes that ASB has reasonably appropriate processes and procedures in place (as specified above) it may, nevertheless, identify Optional Recommendations for ASB to consider.
- 4 In the event that the Review concludes that ASB does not have reasonably appropriate processes and procedures in place (as specified above), then the independent reviewer will specify Required Recommendations and the independent reviewer may also make Optional Recommendations.
- 5 Subject to the parties and the independent reviewer agreeing a different timetable:
 - (a) ASB will request the independent reviewer to provide a draft of its report to ASB within six weeks of the date on which ASB and the FMA agree the independent reviewer's terms of reference ; and
 - (b) ASB will have a further three weeks to provide comments on the draft report to the independent reviewer; and
 - (c) within three weeks of providing its comments, ASB will request the independent reviewer to provide to the FMA (on a confidential basis) the independent reviewer's final report.
 - (d) Subject to clause 7, ASB agrees to implement any Required Recommendations by 18 December 2015 or such other timeframe as is reasonably practicable and agreed with the FMA.
- 6 Where ASB does not agree that a Required Recommendation is necessary, it will provide its reasons for this view to the FMA and the FMA will consider in good faith whether it will require ASB to implement the Required Recommendation or whether some adjustment to the Required Recommendation can reasonably be made.
- 7 ASB agrees to consider in good faith the implementation of any Optional Recommendations.

8 For the purpose of this Schedule:

Agreed Products means:

8.1 Interest Rate Swaps; and

8.2 ASB Term Fund.

Required Recommendation means a change to ASB's processes and procedures which, in the reasonable opinion of the independent reviewer, is necessary to prevent a substantial risk of false, misleading or deceptive representations being made in relation to the marketing, promotion and sale of the Agreed Products.

Optional Recommendation means a change to ASB's processes and procedures which, in the reasonable opinion of the independent reviewer, is desirable to further minimise the risk of ASB making false, misleading or deceptive representations in relation to the marketing, promotion and sale of the Agreed Products.

