AECgroup

Parliamentary Submission

Inquiry into Financial Products and Services in Australia

July, 2009

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Company Background

The AEC*group* is one of the largest and most diverse economics, finance and property consulting firms in Australia, with specialist skills across numerous industry sectors. Staff have decades of experience in financial services and policy development. The AEC*group* conducts a wide variety of work for public and private sector clients involved in the following sectors:

- Agriculture
- Aquaculture
- Horticulture
- Mining
- Construction
- Tourism
- Finance
- Property
- Retail
- Aged Care
- Transport
- Manufacturing
- Energy and Water
- Education and Health

Expertise extends beyond technical economics and planning consulting services to Market Research, Design and Advertising, Marketing, Finance, Government Relations, Organisational Consulting, Property Advisory and Information Technology services. Access to these professional level skills sets which combine technical expertise with practical experience enables the AEC*group* to provide consulting solutions that provide real value for our clients.

The AEC*group* has been providing detailed social and economic analysis to communities and regions across Australia for almost twenty years. The AEC*group* applies general economic principles alongside tried and tested business acumen which results in reliable and practical solutions to a wide spectrum of clients.

Executive Summary

The Perfect Storm

In early October 2008 Executive Chairman and Principal Economist, Mr Carey Ramm, was interviewed on the ABC regarding the state of the economy and financial markets focusing on the unwinding of global leverage. In the interview he made reference to margin lending and its role in amplifying the downside risk to both personal investors and the economy. He highlighted the fact that this bear market would be different to those in the past due to the increasing use of margin lending as an investment tool by small individual investors - many of whom would be wiped out by the market correction being experienced.

Literally within minutes of completing the interview Carey's office was inundated with calls from distressed clients of Storm Financial. In discussions with these people, several of whom were retirees or average income earners, it was immediately evident that they were heavily exposed and leveraged with margin loans used to purchase indexed share funds. These people were advised to remortgage their home with a home-equity loan or even remove their superannuation and use these funds to take out margin loans.

AEC*group* Directors were shocked at how every day people were able to borrow millions of dollars, without having the personal income to service the loans if there was a problem, and emotionally shattered by the position they were in.

The AEC*group* Directors then resolved to help these people and treat the project as part of our Corporate Social Responsibility program. AEC*group* has undertaken similar projects throughout its history as it's our way of giving back to the community in which we live and work. It was apparent as a first step legal representation was required for the affected people. However, the clients were financially ruined and had no capacity to pay for lawyers. Lawyers Slater and Gordon and Connolly Suthers were approached by AEC*group* with the information collected to date and they agreed to join the campaign in November.

It was at this time AEC*group* prepared and implemented a media engagement campaign. The story was quickly picked up by the major news outlets and coverage was widespread including stories by 4 Corners, Lateline, A Current Affair and 60 Minutes. The media campaign has highlighted to government, politicians and regulators that a major problem exists within the financial services sector that requires immediate attention.

It also became very clear that the size and magnitude of this financial disaster was going to exceed anything Australia had seen prior - 14,500 victims, of which 4,000 were facing complete financial ruin, and losses exceeding $3 billion. In addition, to these shocking statistics is the human dimension of the enormous stress on individuals and families.

In December, the firm at the heart of this disaster, Storm Financial, collapsed and ASIC announced it would begin a formal investigation. AEC*group* have supplied copies of the information it has collected to ASIC to assist this investigation.

In January SICAG (Storm Investors Consumers Action Group) was established independently of AEC*group* to provide support to victims.

Whilst this project is ongoing it has already become clear that this disaster has far reaching implications for the financial services industry. These include:

- Changes to margin lending have recently been announced;
- It has placed focus on the remuneration structures of financial planners, in particular the commission based income they receive;
- Substantially improve regulation and compliance in the financial planning industry; and
- An improvement in the quality of appropriate financial advice. This is the ideal opportunity for ASIC to undertake a test case to clarify Section 945A of the Corporations Act - the part of the law that requires a planner to have a reasonable basis for the advice.

The Aftermarth

To document the full scale of the Storm Financial fiasco, the AEC*group* (AEC*community research & strategy*) has conducted a detailed survey of Storm's former clients in conjunction with SICAG. A total of 421 surveys were received and collated. A second survey (314 responses) was conducted in relation to margin loans (see Appendices A and B for the full survey questions and results). The costs arising from Storm Financial's collapse are astounding. Of those surveyed:

- Approximately 43.5% will have to sell their home to repay debts;
- 39.1% of those affected were retired;
- 24.7% will now have to rely on Centrelink benefits; and
- 61.0% will have to return to the workforce due to the losses.

Financial losses understate the true impact of the collapse. Those affected are experiencing extreme emotional stress including 27.0% of those surveyed who are now on medication for depression.

Key Recommendations

This collapse has far reaching implications for the financial services industry. Key recommendations from our analysis are as follows:

1. Clearly distinguish financial advisers from salespersons;
2. Remove conflicts of interests by permitting financial advisers to only charge a flat-fee, paid from the client's savings (and not from new borrowings recommended by the adviser);
3. Significantly increase ASIC's resources to police the financial services industry. Between 2002/03 and 2007/08 the number of financial services licensees in Australia increased by more than 660%. Over the same period, staffing levels at ASIC, the body charged with issuing licenses and policing the industry, increased by less than 20%;
4. ASIC to establish a dedicated compliance team for the financial services industry conducting regular audits and on-site inspections;
5. Out of the surveillance program ASIC should publish a 3-star grading system of financial advisers that would direct consumers to higher quality advisers and provide poor performing advisers with something to strive for;
6. Establish a Professional Standards Board within ASIC similar to that proposed in the UK. The Board would:
    a. Be independent of the industry and its professional bodies;
    b. Create and administer a code of ethics for the industry;
    c. Have powers to discipline and deregister advisers; and
    d. Set a program of continuing education for financial advisers;
7. Reform the legislation of retail margin loans to reflect their use by small investors including:
    a. Require all advertising of margin loans to explain the downside risks of leverage;
    b. Capping the LVR ratio at a conservative rate (e.g. 50%) as is the case in the US;
    c. Require margin lenders to assess a borrower's ability to service the loan;
    d. Require margin lenders to notify borrowers of a margin call; and
    e. Remove the option for margin lenders to terminate loans at their will;
8. ASIC to undertake a financial education campaign incorporating school and workplace seminars (again, the UK model could be followed).

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1. The Role of Financial Advisers

1.1 Failings of the Profession

AEC*group* believes there are three key obligations of a financial adviser to their client:

1. The advisor avoids **conflicts of interest** and acts in the best interests of the client, not their personal or employer's interests;
2. Legally, advisers are required to have a **reasonable basis** for any recommendations or advice they provide; and
3. The advisor will provide all **information** the client would need to make their own judgment on the suitability of a product.

ASIC's own research and the episode of Storm Financial demonstrate that at least some advisers are regularly failing on all three fronts.

Conflicts of Interest

For clients to receive objective advice, advisors must be acting independently of financial product suppliers. Research by ASIC (2006, p.2) has shown that "unreasonable advice" regarding superannuation is 3-6 times more common where there is a conflict of interest over remuneration. Similarly, Storm Financial's connections with CBA and other margin lenders clearly skewed its product advice – 87.8% of those surveyed were advised to use the equity in their home to invest in shares.

Current arrangements for disclosing conflicts of interest are clearly ineffective. ASIC's research (2006, p.10) on superannuation advice found conflicts of interest on remuneration were not adequately disclosed on 12% of occasions where a Statement of Advice was given. In an additional 15% of cases the disclosures provided were probably not compliant with legislation.

Reasonable Basis

Despite a legal obligation to have a reasonable basis for advice, the industry regularly makes recommendations with no regard for the needs and risk tolerance of clients. ASIC's survey of superannuation advice (2006, p.2) found that 16% of advice provided was not reasonable given the client's needs. Likewise, Storm Financial consistently imposed the same one size fits all leveraged strategy with no regard for their client's risk tolerance or ability to service the loans.

ASIC needs to undertake a test case to clarify Section 945A of the Corporations Act - the part of the law that requires a planner to have a reasonable basis for the advice.

Information

The risk of consumers making poor investment choices is reduced if on receiving professional advice, they then make their own decision on the appropriateness of the recommendation. This would require some basic information from the advisor about the financial product and their reasoning for recommending it.

Non-compliance with disclosure requirements pervades the industry. The survey of superannuation advice (ASIC 2006, p.2) found that 46% of advisers failed to provide a written Statement of Advice when required. Storm Financial even failed to comply with a much simpler legal requirement, to supply a Product Disclosure Statement (PDS).

Table 1.1. Product Information provided by Storm Financial

Proportion	Statistic
Proportion of clients that did not receive a Storm Financial / Colonial PDS	41.4%
Proportion of clients that did not read the PDS or have it explained	59.3%

Source: AEC*group*

Investors must also understand the information conveyed to them. PDSs are too long, legalistic and border on incomprehensible. They need to be shorter, easier to read and focus on informing the investor, not giving the issuer legal protection.

2. The Way Ahead

The public has lost confidence in financial planners. In a recent survey, only 25% of Australians rated planners very high or high for ethics and honesty (Price 2009). Policy needs to be directed at three broad areas to restore public confidence:

- Reforms to compensation arrangements;
- Regulation; and
- Disclosure and Education.

Consumer protection needs to be taken seriously by the Government. If the Government expects people to plan and fund their own retirement then it needs to restore the public's confidence in the financial planning industry. Failure to do so will lead to inadequate planning for retirement and a continued reliance on the pension system.

2.1 Compensation Arrangements

Those around the industry have long recognised the distorted and inappropriate advice that results from remuneration arrangements between advisers and product suppliers.

Financial advisers should only be permitted to charge flat upfront fees.

The method of payment also matters, it should come from the client's savings, not through loans originated on the recommendation of an adviser – as was the case at Storm Financial. It seems to be a case of "out of sight, out of mind", this seemingly free advice discouraged people from scrutinizing the advice closely. Upfront payment for advice would encourage consumers to carefully consider the quality of service.

This fee-for-service arrangement would also preclude soft dollar benefits which skew advice towards particular products in the same manner as hard commissions. Moreover, as these soft benefit structures can be quite complex, effective disclosure, so that consumers understand the ramifications of these structures, is perhaps impossible to achieve.

Claims a fee-for-service arrangement would put financial advice beyond the reach of most Australians are simply false. Accountants, solicitors and many other business services operate on a fee-for-service basis. The only "advisers" at risk from a fee-for-service model are really operating as agents of financial institutions that lack the skill to advise their clients on the merits of different products.

Commission-based businesses could continue to operate but would need to be clearly identified as a salesperson of financial products not an adviser. There would need to be adequate warnings on all advertising material that such businesses exist to sell you a product. This would create an adviser and distributor structure for purchasing financial products.

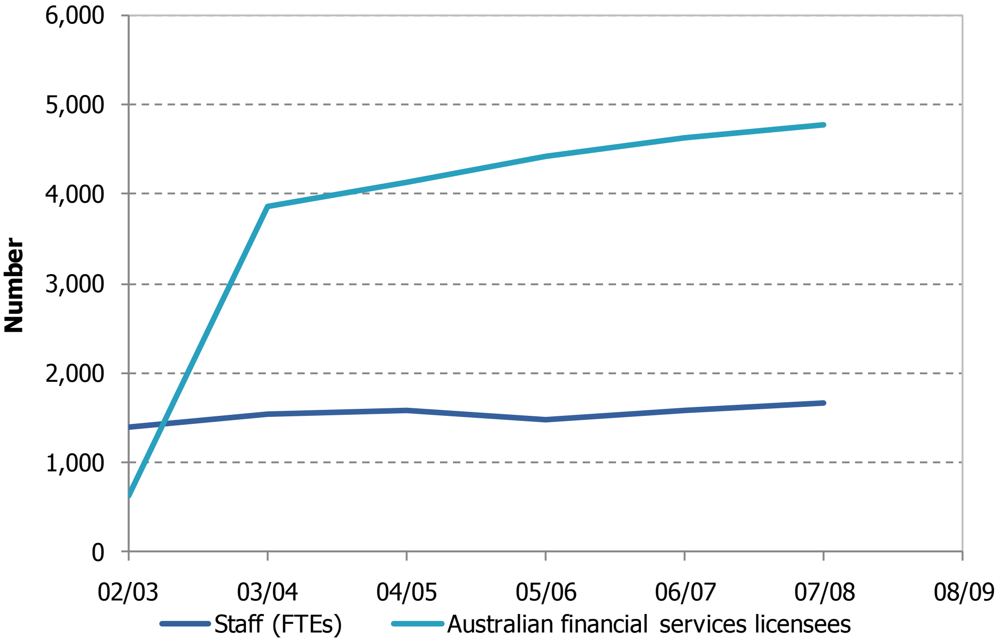
It is hard to think of another industry where it is so difficult for a consumer to distinguish a financial adviser from a salesperson. It is clear from the Storm Financial debacle that the majority of its staff were simply salespeople operating with a one size fits all model. This distinction was further muddied by the qualifications held by its staff and the promotion of these qualifications in the sales process. Storm Financial had a rather dubious arrangement with a tertiary education facility to provide Master of Applied Finance qualifications to its staff. All Storm staff who undertook this course received the qualifications. How someone is eligible to enter a Masters program, let alone receive the qualifications, without a prerequisite bachelors degree is concerning.

2.2 Regulation

2.2.1 Government Regulation

ASIC's current resources to police the financial services industry are inadequate and need to be increased dramatically. Between 2002/03 and 2007/08 the number of financial services licensees in Australia increased by more than 660%. Over the same period, staffing levels at ASIC, the body charged with issuing licenses and policing the industry, increased by less than 20%. It stands to reason that the quality of ASIC's surveillance must have deteriorated over this period. The research of superannuation advice commissioned by ASIC in 2006 appears to support this. Non-compliance was shown to be high regarding conflicts of interest and the failure to provide a written Statement of Advice, yet little seems to have happened in the time since. If the Federal Government is serious about protecting the superannuation and investment assets of Australians, then financial resourcing for ASIC needs to be substantially increased.

Figure 2.1. ASIC's Resource Constraints



Source: ASIC (2008)

Although under resourced, ASIC's surveillance program should still reveal the most serious cases of malpractice. Practices at Storm Financial clearly should have sounded alarm bells with the regulator:

- Clients were regularly not receiving PDSs from Storm Financial (see Table 1.1);
- There were suggestions the company was not operating honestly with regard to loan applications (Pascoe 2009); and
- They were selling a leveraged product clearly inappropriate for much of their client base.

ASIC needs to have a dedicated compliance team, consisting of specialists that are experienced with the financial services sector that is proactive and does ongoing audit checks. APRA has developed sophisticated modules that provide a framework for reviewing its regulated institutions. The modules deal with onsite and off-site components of prudential reviews and could be easily used as a benchmark for monitoring financial service providers by ASIC.

The goal of this surveillance should not stop at compliance with the law. Out of the surveillance program ASIC should publish a 3-star grading system (based on a risk assessment matrix) of financial advisers that would direct consumers to higher quality advisers and provide poor performing advisers with something to strive for. Such independent ratings systems are an accepted part of other industries and are generally trusted by consumers. Advisers with a 1-star rating will lose custom and market forces will act to lift industry standards. Currently, disclosure of malpractice is not transparent and the public is sometimes unaware their adviser is a poor performer (several Storm Financial directors and advisers had compliance and disclosure issues with their former dealer group and one had ASIC enforced remediation). The government must take ownership of this process as the industry has been shown to be ineffective at policing its own standards.

The only advisers that will object to this system are those that won't be able to meet industry standards. Criteria should include the appropriateness and quality of advice, compliance with industry standards and corporate governance.

Recent experience with Storm Financial and other rogue operators highlights several specific aspects of current regulations that need to be amended:

- Despite evidence several years ago that many advisers did not have a reasonable basis for their recommendations, which is a legal obligation, the issue remains clouded. This is the ideal opportunity for ASIC to undertake a test case to clarify Section 945A of the Corporations Act - the part of the law that requires a planner to have a reasonable basis for the advice. The definition of a reasonable basis for advice needs to clarified, and this requirement enforced;
- ASIC currently restricts some poor performing financial advisors from providing personal advice. That is, they are prevented from giving advice which takes into account the objectives, financial situation and needs of clients. It is difficult to see how restricting non-compliant advisers to providing general advice, that does not consider personal circumstances, reduces the risks for consumers;
- Greater penalties need to be imposed on individual financial advisers. If an adviser believes the practices encouraged by their employer are not in the best interests of their clients, legislation should obligate the adviser to act on this belief. Advisers at Storm Financial would have known the advice they were providing could impose extreme financial hardship on their clients, and that these clients were not properly informed. Commission structures clearly clouded their judgement. In one example, a regular advisor at Storm Financial's Townsville office earned more than $450,000 in 2007/08 of which more than $350,000 was commission based income. Some of these advisers have continued working at other firms (Pascoe, 2009); and
- Auditors at the lending institutions that supplied loans to Storm clients were either remiss in their duties or looked the other way due to the profitability of the business they were writing. Surely the internal risk auditors at the BoQ, for example, must have had their interest raised at the significant volume of business that was transacted at the North Ward Townsville branch from a single source (with loans across Australia) that was so far beyond the average performance of other branches (in 2006/07 the North Ward branch averaged $16m per month in loan draw-downs compared to the next best performing franchise branch in Australia which achieved $7m per month). Similarly, the quality of the loan documentation from this branch must have also raised concerns with loan irregularities including inflated incomes for retirees (one supposedly earning $104,000 net per month), investment income being included but investment expenses being excluded, loans being approved before being applied for, loan amounts being changed without signatures, loan types being changed without signatures and even applicant signatures missing. Whilst ASIC does have a program for monitoring the resignation of auditors from particular companies, the program does not appear comprehensive enough to capture all issues raised and needs to be improved.

2.2.2 Self-Regulation

On top of Government regulation several professional bodies attempt to impose professional standards and codes of ethics on the industry. Experience has shown this self-regulation is ineffective and confusing to the general public. Supposed codes of ethics have proved to be window dressing. If anything, these codes and accreditations may have created a false sense of security among consumers by creating a perception somebody is policing the industry. This is far from the case.

The main industry body for financial advisers is the Financial Planning Association (FPA) which administers a code of ethics and a certification program for members. Storm Financial was a principal member of the FPA and four of the company's advisers were Certified Financial Planners (Paech 2009, p.14). The FPA did not commence investigations into Storm Financial until late November and has failed to condemn the company's business practices.

This is hardly surprising, the FPA is an industry body, designed to advance the interests of member advisers and institutions.

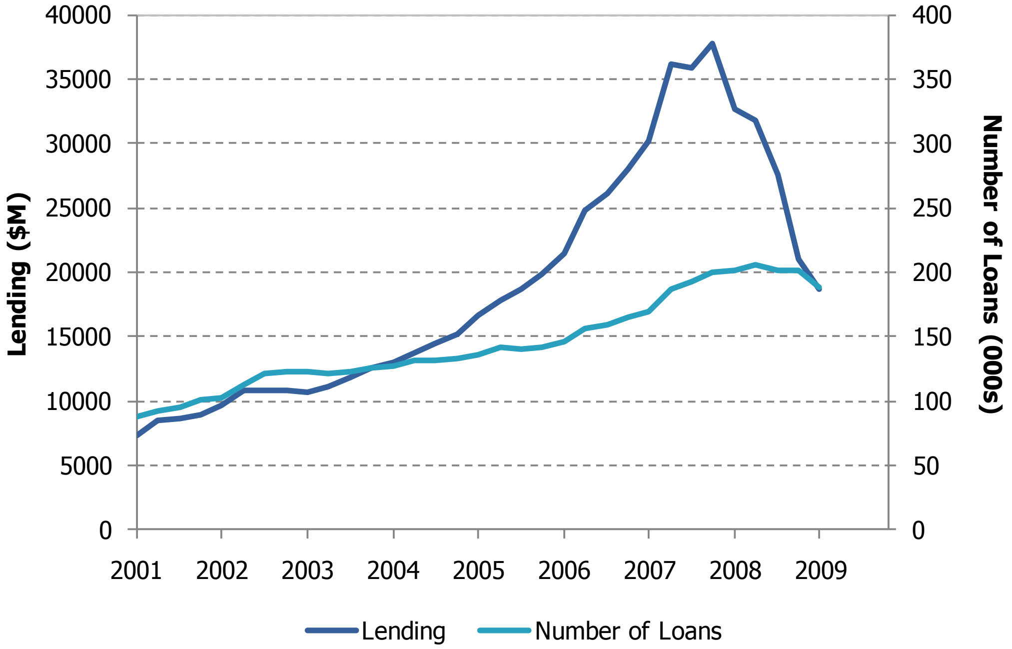
ASIC should oversee the creation of a Professional Standards Board for the industry similar to that advocated in the UK (Financial Services Authority 2008a, p.47) with the following features:

- Independence from the advisory industry with all Board members fully independent of the industry, and professional bodies;
- The Board would create and administer a new code of ethics for financial advisers;
- Have powers to discipline and deregister advisers; and
- The Board would set programs of continuing education for the industry (including training in softer skills in communication and listening to gauge the needs of clients).

2.2.3 Regulation of Margin Loans

Margin loans were at one stage a specialised financial product utilised by institutional investors and high net worth individuals, who had the cash reserves to weather substantial losses on a margin loan. The past few years has seen exceptional growth in margin loans with their extension to small investors.

Figure 2.2. Margin Loans Outstanding



Source: RBA (2009)

Leverage magnifies the gains and losses on equity investments. Much of the growth in margin lending in Australia has occurred when Australia's share market has performed strongly. The recent volatility in the share market is nothing new and many of the retail investors caught out by margin loans were seemingly unaware of the risks they were accepting.

Since 1960, there have been 9 bear markets occurring on average every 5.4 years, lasting an average 15 months with an average market fall of 34%. The current bear market is a big fall but it is in line with the historical experience of 1973 and 1987. On average it takes 41 months after the market low point for the market to set a new high and the average gain in the first 12 months after the low is 32%.

Table 2.1. Bear Markets in Australian Shares since 1960

Bear market in Australian shares	Months to low	% fall	Months after low to make new high	% gain in first 12 months after low
Sep 60 – Nov 60	2	-23.2	33	+12
Feb 64 – Jun 65	16	-20.4	25	+9
Jan 70 – Nov 71	22	-39.0	94	+52
Jan 73 – Sep 74	20	-59.3	59	+51
Nov 80 – Jul 82	32	-40.6	17	+39
Sep 87 – Nov 87	2	-50.1	75	+35
Aug 89 – Jan 91	15	-32.4	30	+39
Feb 94 – Feb 95	12	-21.7	20	+25
Mar 02 – Mar 03	12	-22.3	15	+27
Average	15	-34	41	+32
Nov 07 - ?	*?*	*?*	*?*	*?*

Source: AEC*group*; *AMP* Capital

So what we are experiencing has happened in the past and will most likely occur in the future and advisers and margin lenders clearly did not impress these risks on their clients.

In the case of Storm Financial, it had experienced a financial meltdown in the relatively mild 2002 bear market, where its Ozdaq Hi Tech Index collapsed causing numerous margin calls for clients. In some cases Storm Financial stepped in to meet margin calls for clients by lending them funds. It would have certainly been clear to any competent financial planner at this time that the Storm Financial model had serious flaws. However it is now apparent that Storm Financial did not heed nor learn from the 2002 warning. The flaws in the model would have also been obvious at the time to Storm Financial's margin lending partners and to the CBA which did perform some due diligence on the business as part of a potential acquisition (which did not proceed for undisclosed reasons).

In general, margin borrowers receive a much lower standard of service from lenders and advisers than for mortgages and other personal loans:

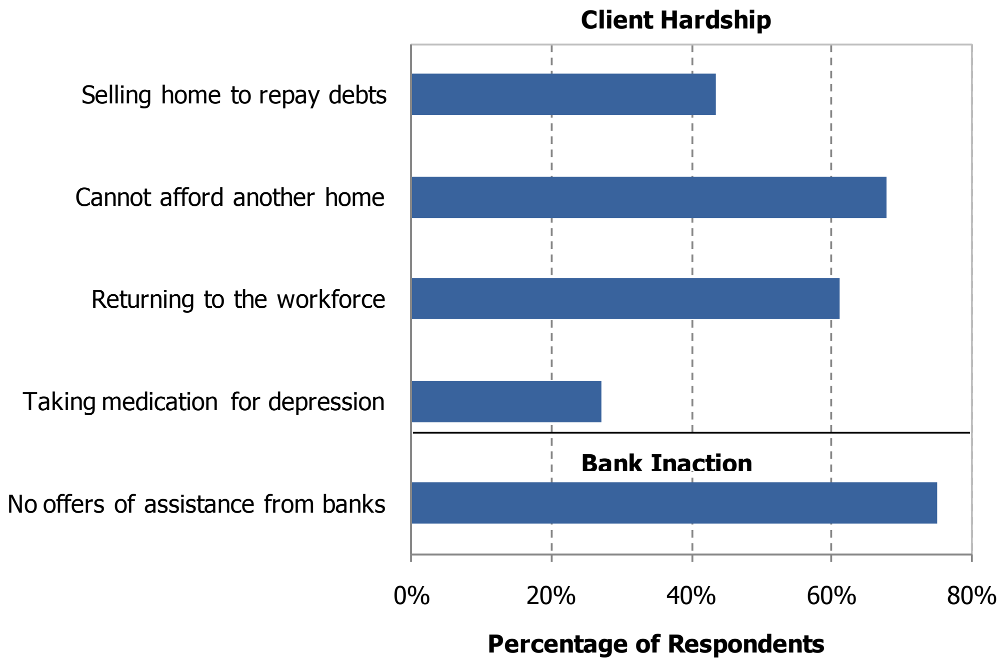
1. Lenders are not showing a **duty of care** to borrowers:

Lenders make no assessment of a household's ability to service the margin loan. Of Storm's clients surveyed, 43.5% expect they will have to sell their home to repay debts and 87.8% had been encouraged to secure the margin loan by borrowing against the equity in the home.

Given the specialised nature of margin loans, bank employees must have queried the large number of such loans coming from Storm Financial. Commission structures, this time within the banks, has made banks complicit to the unethical sales practices of advisers. Compliance by margin lenders too has been shoddy with AEC*group* seeing evidence of signatures of borrowers being supposedly simultaneously witnessed by margin lenders in other cities.

Most margin lenders associated with Storm Financial were members of the Australian Bankers' Association (ABA), which has a Code of Banking Practice. CBA, Westpac, BoQ, NAB, ANZ, Suncorp and St. George have all adopted the Code, which includes a hardship provision that applies in certain circumstances. Despite many of Storm's victims clearly experiencing financial hardship, at the time of the survey three quarters of survey respondents had received no offers of assistance from their margin lender. Like the FPA, this is further evidence of the inability of an industry association to impose professional standards on members.

Figure 2.3. Storm's Carnage



Source: AEC*group*

2. **Communication** of advisers and lenders with margin borrowers is almost non-existent:

Banks engaged Storm Financial as a distributor but made no effort to confirm the company was providing adequate advice about how these margin loans operated. Very few clients were aware the margin loan could be withdrawn without a margin call (Table 2.2). Of concern, this is not unique to Storm Financial, the Australian Treasury made the same observation in mid-2008, prior to the Storm episode erupting (2008 p.29).

This again shows the deficiency of adviser disclosure. Secondly, there is a wide disparity in terms and conditions between retail margin loans and other consumer loans. Banks currently have a free option to withdraw from margin loans, these arguments could equally apply to a mortgage on an investment property, but the public doesn't accept it. This option should be removed from retail margin loans.

The margin call process was also misunderstood. Investors clearly had the expectation their adviser would keep them informed of margin calls on their loans – 98.3% of those surveyed trusted their adviser to keep them informed and manage their portfolio. Instead, few received a margin call before the index fund was terminated. There were also numerous Storm Financial clients who had the financial capacity to meet the margin calls but received no communication from either Storm Financial or their margin lender. Retail investors, who don't have access to real-time financial feeds clearly need to be notified of a margin call. Legislation needs to designate responsibility to the lender of notifying the client of the margin call.

Table 2.2. Communication of Margin Lenders with Retail Clients of Storm Financial

Question	Proportion of Respondents (%)
Never received a margin call	73.6%
Felt margin lenders had a duty of care to advise investors before terminating funds	92.8%
Were unaware a portfolio could be terminated in negative equity without a margin call	93.3%

Source: AEC*group*

Changes to Margin Loan Regulations

Regulation of retail margin loans needs to reflect their use by consumers that do not have timely access to financial information or the ability to withstand the large financial losses that can result from leveraged investment in equities. The following changes are suggested:

- A conservative cap on the loan-to-valuation ratio must be imposed (e.g. 50%), as has been the case in the US since the Great Depression;
- The margin lender and financial planner should have dual responsibility to ensure the client is fit to borrow money and meet their obligations - cash flow to meet interest payments and margin call obligations. If the client cannot meet a margin call into the future because their financial position has changed then it's the clients responsibility to inform the margin lender when this has occurred;
- Margin lenders must assess the borrower's ability to service the loan and stress test the household's portfolio under previous extreme, but plausible, market movements (e.g. the 1987 stock market crash);
- Legislation needs to designate responsibility to the lender to make reasonable efforts in notifying the client of a margin call;
- The lender's option to terminate a margin loan should be withdrawn. This would be consistent with the terms of other consumer loans and also encourage the assessment of loans based on serviceability, rather than just the quality of the collateral for the loan;
- All marketing material needs to highlight the downside risks of leverage. Advertising currently places too much emphasis on returns during a bull market; and
- In all relationships between financial institutions and its distributors, legislation should develop a checklist of warning signs (e.g. a rapid increase in margin loan applications from a particular distributor) that require the institution to notify ASIC. Professional equity analysts monitor the earnings quality and governance of listed companies, there is no reason lenders cannot monitor their distributors in a similar fashion.

2.3 Discolsure and Education

ASIC's own research, and the episode at Storm Financial confirm that disclosure by financial advisers is often not compliant with legislation. This shows consumers don't know what to expect from an adviser, such as a written Statement of Advice and a PDS. It is also further evidence that surveillance of the industry is inadequate. A second issue is whether consumers can make an informed judgement from the information provided. This requires effective communication by advisers and a basic level of financial literacy among consumers.

Regarding effective disclosure, written advices and PDSs need to be to the point and easy to read. This information could be made more accessible if drafted to attain certain levels of readability indices. In the US, legal and health information is required to achieve certain readability levels, this could easily be applied to PDSs. In addition, total costs to the client should be provided by the financial planner and lending provider in a simple format. The financial planner should break down all costs to the client in dollar terms and as a percentage charged up front and ongoing (broken up by product costs, platform fees, shelf space fees, soft dollar or rebates paid by product providers and ongoing financial planner fees and charges).

Whilst ASIC does provide some services to promote financial literacy, Australia's financial literacy program lags behind other countries. In the UK a strategy and work program has been developed for UK schools, further and Higher Education institutions and the workplace. For example, a program is being funded in the UK to deliver financial information to adults through seminars and information packs in workplaces. Printed guides are distributed explaining the features, benefits and risks of financial products - such as mortgages, insurance and retirement options. Between 2006 and 2011 the UK is targeting the delivery of a "Make the Most of your Money" seminar to 500,000 people (Financial Services Authority 2008b, p.56).

Face-to-face financial education by ASIC seems to rely upon a presence at financial planning events. Much of the audience reached is likely to already be thinking actively about their investments and possibly more informed than the general public. Australia's financial literacy program needs to be broadened and incorporate school and workplace seminars.

The importance of financial literacy should not be understated. Instances of malpractice by advisers can easily be avoided if consumers know the services required from an adviser and are able to ask probing questions about the recommendations they receive.

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Appendix A: Survey Forms

Survey One

	Question	Yes	No	Verbatim
1	Which Storm Office did you have dealings with?			
2	Name of your advisor			
3	Did the advisor suggest that you borrow against the equity in your home for share investment			
4	Did the advisor tell you that the risk of losing your hoe exists should markets drop?			
5	Are you retired			
6	Do you now have to rely on Centrelink benefits?			
7	Will you need to sell your home to repay debt on either Home Loan or Margin Loan			
8	Did you end up with Negative equity on the Margin Loan			
8a	If yes, show the LVR that was reached before you got a call from the Margin Lender re Negative position			
9	What was the amount of your Margin Loan Limit? (express in nearest 100,000) i.e. $2 million limit record as 20			
10	Did you receive a Margin call prior to the sell down of Index fund?			
11	Have you made a complaint to ASIC regarding Storm or your bank?			
12	Did you invest your superannuation with Storm & Value of super placed with Storm Fund?			
13	Did you trust Storm Financial to Manage your portfolio and keep you informed			
14	Were you referred to Storm for Financial Advice by a bank?			
14a	If yes, name of the bank			
15	If you sell your home, can you afford to purchase another house with remaining balance			
16	Will you be forced to return to the workforce as a result of the losses?			
17	What is your age (if a couple, the aged of eldest partner)			
18	Have you received any contact from the Bank or Margin Lender demanding payment?			
19	What is the estimated amount in dollars that you have lost (express in $,000)			
20	Are you currently taking any medication for Depression?			
21	Did you sign the application for Bank finance in a Storm office?			
22	Did you have any contact with the Bank regarding the loan application?			
23	Have you been refused finance by the Bank for investment prior to Storm obtaining approval?			
23a	If yes, name of the bank			
24	When you signed the authority in early October did you expect that Shares would be sold down to cash to cover the Margin loan and have balance in cash account to reenter the market at a later date			
25	Has your bank been in contact and made any offer to assist you?			
25a	If yes, name of the bank			
26	Has your bank refused to supply you with details of loan application form?			
26a	If yes, name of the bank			
27	Did Storm suggest you seek independent legal advice before signing the loan documents?			
28	For clients with CBA loans, was the CBA disclaimer letter explained to you and was it suggested you seek legal advice regarding this document?			
29	For clients with fixed rate loans, were all the forms organised by Storm on your behalf?			
30	Have you got a copy of the Storm Financial/Colonial Product disclosure statement?			
31	Did you read it or have someone explain it to you?			
31a	If yes, name of person explaining			
32	Would you have leveraged into the Equities Market with a Margin Loan had you know that there was a chance of not having a Margin Call and ultimately have your portfolio sold out in Negative equity?			
33	Do you believe that, in the circumstances where you were not in dispute with your Margin Lender, that they had an obligation of duty of care to contact you before selling down your portfolio and closing down your Storm funds			
34	In the time that you had a Margin Loan, did you ever have a Margin Call?			
34a	If yes, did your client adviser or the bank advise you that you were in Margin call?			

Additional Survey: Margin Loans

Number	Question	Response
1	At what point did the margin lender sell down your investments LVR%?	
2	Which financial institution did you have the Margin Loan with?	
3	If you borrowed against the home loan, what is the residual debt that you still have to repay the loan?	
4	Which Bank conducts your Investment Home Loan?	

Appendix B: Survey Analysis

Following the collapse of Storm Financial Limited, a survey was sent to clients of this financial planning firm as part of the Storm Investors Consumers Action Group's (SICAG) investigation in connection with margin loans and related advice given to Storm clients.

A total of 421 surveys were received and collated by the AEC*group*. A copy of the survey questionnaire can be found in **Appendix A**.

This section presents the results of the survey.

Survey Results

The first question asked clients to nominate the Storm Office that they had dealings with. The most frequently nominated offices were 'Townsville' (32.0%), Redcliffe (17.3%) and Brisbane (13.0%).

Table 1: Which Storm Office did you have dealings with?

Response	Percentage (%)
Townsville	32.2%
Redcliffe	17.5%
Brisbane	13.0%
Cairns	11.6%
Mackay	7.3%
Rockhampton	6.1%
Sydney	3.4%
Nundah	2.0%
North Sydney	1.4%
Newstead	1.1%
Gold Coast	0.7%
Werribe Vic	0.7%
Fortitude Valley	0.5%
Maroochydore	0.5%
Robina	0.5%
Geelong	0.5%
Sunshine Coast	0.5%
Holland Park	0.2%
Fortitude Valley	0.2%
Tannum Sands	0.2%
Total	**100.0%**

Note: Multiple response format – respondents can nominate more than one Storm office
A few respondents nominated Advisor name, rather than Office
Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

A total of 87.8% of respondents indicated that their Advisor suggested that they borrow against the equity in their home for share investment.

Table 2: Did the advisor suggest that you borrow against the equity in your home for share investment

Response	Percentage (%)
Yes	87.8%
No	10.3%
N/A	1.9%
Total	**100.0%**

Source: Storm Financial Survey 2009

A total of 89.2% of respondents claimed that the Advisor did not tell them that the risk of losing their home exists should markets drop.

Table 3: Did the advisor tell you that the risk of losing your home exists should markets drop?

Response	Percentage (%)
Yes	4.8%
No	89.2%
N/A	6.0%
Total	**100.0%**

Source: Storm Financial Survey 2009

Close to 40.0% of respondents were retired (39.1%).

Table 4: Are you retired?

Response	Percentage (%)
Yes	39.1%
No	60.9%
Total	**100.0%**

Source: Storm Financial Survey 2009

Nearly one in four indicated that they now have to rely on Centrelink benefits (24.7%).

Table 5: Do you now have to rely on Centrelink benefits?

Response	Percentage (%)
Yes	24.7%
No	72.4%
N/A	2.9%
Total	**100.0%**

Source: Storm Financial Survey 2009

Nearly half of all respondents will need to sell their home to repay debt on either Home Loan or Margin Loan (43.5%).

Table 6: Will you need to sell your home to repay debt on either Home Loan or Margin Loan?

Response	Percentage (%)
Yes	43.5%
No	49.3%
N/A	7.2%
Total	**100.0%**

Source: Storm Financial Survey 2009

Respondents were fairly equally distributed between those who ended up with negative equity on the Margin Loan (48.9%) and those who didn't (48.2%).

Table 7: Did you end up with negative equity on the Margin Loan?

Response	Percentage (%)
Yes	48.9%
No	48.2%
N/A	2.9%
Total	**100.0%**

Source: Storm Financial Survey 2009

Of those clients who ended up with negative equity on their margin loan, a high proportion reached a loan to valuation ratio (LVR) of 100-110% (40.5%) before they received a call from their Margin Lender regarding negative position. The next most commonly cited LVR was 90-100% (22.0% of respondents), followed by 110-120% (15.5% of respondents).

Table 8: If yes, show the LVR that was reached before you got a call from the Margin Lender re Negative position

Loan to Valuation Ration (%)	Percentage (%)
Nil	1.2%
<10	1.2%
40-50	1.2%
60-70	1.8%
70-80	2.4%
80-90	8.9%
90-100	22.0%
100-110	40.5%
110-120	15.5%
120-130	4.8%
130+	0.6%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

A high proportion of clients had a Margin Loan limit of approximately $1 to $5 million dollars (42.4%), followed by $500,000 to $1 million dollars (29.9%).

Table 9: What was the amount of your Margin Loan Limit?

Response	Percentage (%)
$0- $500,000	26.4%
$500,000 - $1M	29.9%
$1- $5M	42.4%
$5M+	1.3%
Total	**100.0%**

Source: Storm Financial Survey 2009

The majority of respondents did not receive a Margin call prior to the sell down of the Index Fund (80.0%).

Table 10: Did you receive a Margin call prior to the sell down of Index fund?

Response	Percentage (%)
Yes	19.3%
No	80.0%
N/A	0.7%
Total	**100.0%**

Source: Storm Financial Survey 2009

A total of 42.4% of respondents have made a complaint to ASIC regarding Storm Financial or their bank.

Table 11: Have you made a complaint to ASIC regarding Storm or your bank?

Response	Percentage (%)
Yes	42.4%
No	56.6%
N/A	1.0%
Total	**100.0%**

Source: Storm Financial Survey 2009

A total of 44.1% of respondents claimed that they had invested their superannuation with Storm.

Table 12: Did you invest your superannuation with Storm?

Response	Percentage (%)
Yes	44.1%
No	55.2%
N/A	0.7%
Total	**100.0%**

Source: Storm Financial Survey 2009

Respondents who invested their superannuation with the Storm Fund were further asked to specify the amount of investment. The majority of clients had invested $150 to $200,000 (12.9%) and $50 to $100,000 (12.9%), followed by $100 to $150,000 (10.5%).

Table 12a: If yes, specify value of super placed with Storm Fund:

Response	Percentage (%)
<$2,000	2.4%
$10-$50,000	9.7%
$50-$100,000	12.9%
$100-$150,000	10.5%
$150-$200,000	12.9%
$200-$250,000	4.0%
$250-$300,000	7.3%
$300-$350,000	4.8%
$350-$400,000	8.1%
$400-$450,000	2.4%
$450-$500,000	8.9%
$500-$550,000	1.6%
$550-$600,000	3.2%
$600-$650,000	4.0%
$700-$750,000	1.6%
$750-$800,000	0.8%
$850-$900,000	2.4%
Over 1 Million	2.4%
Total	**100.0%**

Note: Only includes 'Yes' responses in Q12
Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

Nearly all respondents trusted Storm Financial to manage their portfolio and keep them informed (98.3%).

Table 13: Did you trust Storm Financial to Manage your portfolio and keep you informed?

Response	Percentage (%)
Yes	98.3%
No	1.4%
N/A	0.2%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

A high proportion of respondents were not referred to Storm for financial advice by a bank (96.7%).

Table 14: Were you referred to Storm for Financial Advice by a bank?

Response	Percentage (%)
Yes	3.1%
No	96.7%
N/A	0.2%
Total	**100.0%**

Source: Storm Financial Survey 2009

Those who were referred to Storm for financial advice by a bank (3.1%), were asked to nominate the name of the bank. The most commonly nominated bank was Commonwealth Bank of Australia (5 responses), followed by Colonial (2 responses) and Macquarie and ANZ Bank (1 response each respectively).

A high proportion of respondents were of the view that if they sold their home, they would not be able purchase another house with the remaining balance (67.8%).

Table 15: If you sell your home, can you afford to purchase another house with remaining balance?

Response	Percentage (%)
Yes	12.0%
No	67.8%
N/A	20.2%
Total	**100.0%**

Source: Storm Financial Survey 2009

Nearly two in three respondents indicated that they would be forced to return to the workforce as a result of the losses (61.0%).

Table 16: Will you be forced to return to the workforce as a result of the losses?

Response	Percentage (%)
Yes	61.0%
No	19.8%
N/A	19.3%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

As can be seen below, the highest proportion of respondents are aged 60-69 years (38.3%), followed by 50-59 years (29.5%).

Table 17: What is your age (if a couple, the aged of eldest partner)

Response	Percentage (%)
20-29	1.5%
30-39	4.4%
40-49	18.3%
50-59	29.5%
60-69	38.3%
70 yrs+	8.0%
Total	**100.0%**

Source: Storm Financial Survey 2009

A total of 44.4% or respondents have received contact from the Bank or Margin Lender demanding payment.

Table 18: Have you received any contact from the Bank or Margin Lender demanding payment?

Response	Percentage (%)
Yes	44.4%
No	53.9%
N/A	1.7%
Total	**100.0%**

Source: Storm Financial Survey 2009

A high proportion of clients estimated that they have lost approximately $1 to $2 million dollars (19.6%), followed by $200 to $400,000 (18.2%) and $400 to $600,000 (17.7%).

Table 19: What is the estimated amount in dollars that you have lost?

Response	Percentage (%)
$0 - $199,000	9.9%
$200 - $399,000	18.2%
$400 - $599,000	17.7%
$600 - $799,000	10.7%
$800 - $999,000	12.9%
$1- $2M	19.6%
$2- $4M	9.7%
$5M +	1.3%
Total	**100.0%**

Source: Storm Financial Survey 2009

Just over one in four respondents are currently taking medication for Depression (27.0%).

Table 20: Are you currently taking any medication for Depression?

Response	Percentage (%)
Yes	27.0%
No	72.2%
N/A	0.7%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

The majority of respondents signed the application for Bank finance in a Storm office (80.1%).

Table 21: Did you sign the application for Bank finance in a Storm office?

Response	Percentage (%)
Yes	80.1%
No	18.4%
N/A	1.4%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

A high proportion of respondents indicated that they did not have any contact with the Bank regarding their loan application (83.1%).

Table 22: Did you have any contact with the Bank regarding the loan application?

Response	Percentage (%)
Yes	16.2%
No	83.1%
N/A	0.7%
Total	**100.0%**

Source: Storm Financial Survey 2009

Nearly all respondents have not been refused finance by the Bank for investment prior to Storm obtaining approval (97.4%).

Table 23: Have you been refused finance by the Bank for investment prior to Storm obtaining approval?

Response	Percentage (%)
Yes	2.1%
No	97.4%
N/A	0.5%
Total	**100.0%**

Source: Storm Financial Survey 2009

Respondents were asked to nominate the name of the bank that had declined their application for investment prior to Storm. The most commonly nominated bank was CBA (3 responses) followed by Westpac (2 responses) and ANZ (1 response).

The majority of respondents were of the view that when they signed the authority in early October, they had expected that shares would be sold down to cash to cover the Margin loan and have balance in cash account to re-enter the market at a later date (82.9%).

Table 24: When you signed the authority in early October did you expect that Shares would be sold down to cash to cover the Margin loan and have balance in cash account to re-enter the market at a later date?

Response	Percentage (%)
Yes	82.9%
No	14.9%
N/A	2.2%
Total	**100.0%**

Source: Storm Financial Survey 2009

Nearly one in four indicated that their bank has been in contact and have made offers to assist (24.2%).

Table 25: Has your bank been in contact and made any offer to assist?

Response	Percentage (%)
Yes	24.2%
No	75.1%
N/A	0.7%
Total	**100.0%**

Source: Storm Financial Survey 2009

The most commonly nominated banks who offered to assist were CBA (71.1%), Colonial (8.9%) and Bank of QLD (7.8%).

Table 25a: If yes, name of the bank:

Response	Percentage (%)
CBA	71.1%
Colonial	8.9%
Bank of QLD	7.8%
ANZ	3.3%
NAB	3.3%
Westpac	3.3%
Other	1.1%
Financial Advisor	1.1%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

A very small proportion of respondents indicated that their bank refused to supply them with details of the loan application form (8.7%).

Table 26: Has your bank refused to supply you with details of loan application form?

Response	Percentage (%)
Yes	8.7%
No	81.6%
N/A	9.7%
Total	**100.0%**

Source: Storm Financial Survey 2009

The most commonly cited banks that had refused to supply clients with details of the loan application form were CBA (42.4%) and Macquarie (18.2%).

Table 26a: If yes, name of the bank:

Response	Percentage (%)
CBA	42.4%
Macquarie	18.2%
Colonial	15.2%
Bank of QLD	15.2%
ANZ	6.1%
St George	3.0%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

The majority of respondents claimed that Storm did not suggest that they seek independent legal advice before signing the loan documents (93.6%).

Table 27: Did Storm suggest you seek independent legal advice before signing the loan documents?

Response	Percentage (%)
Yes	4.5%
No	93.6%
N/A	1.9%
Total	**100.0%**

Source: Storm Financial Survey 2009

A high proportion of clients with CBA loans indicated that the CBA disclaimer letter was not explained to them nor was it suggested that they seek legal advice regarding the document (60.9%).

Table 28: For clients with CBA loans, was the CBA disclaimer letter explained to you and was it suggested you seek legal advice regarding this document?

Response	Percentage (%)
Yes	1.0%
No	60.9%
N/A	38.1%
Total	**100.0%**

Source: Storm Financial Survey 2009

The majority of clients with fixed rate loans affirmed that all forms were organised by Storm on their behalf (88.5%).

Table 29: For clients with fixed rate loans, were all the forms organised by Storm on your behalf?

Response	Percentage (%)
Yes	88.5%
No	5.5%
N/A	6.0%
Total	**100.0%**

Source: Storm Financial Survey 2009

Respondents were fairly equally distributed between those who owned a copy of the Storm Financial / Colonial Product disclosure statement (42.6%) and those who did not (41.4%).

Table 30: Have you got a copy of the Storm Financial/Colonial Product disclosure statement?

Response	Percentage (%)
Yes	42.6%
No	41.4%
N/A	16.0%
Total	**100.0%**

Source: Storm Financial Survey 2009

Over half of all respondents did not read the Storm Financial / Colonial Product disclosure statement or have someone explain it to then (59.3%).

Table 31: Did you read it or have someone explain it to you?

Response	Percentage (%)
Yes	25.7%
No	59.3%
N/A	15.1%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

A high proportion of respondents would not have leveraged into the Equities Market with a Margin Loan had they known that there was a chance of not having a Margin Call and ultimately having their portfolio sold out in Negative equity (93.3%).

Table 32: Would you have leveraged into the Equities Market with a Margin Loan had you know that there was a chance of not having a Margin Call and ultimately have your portfolio sold out in Negative equity?

Response	Percentage (%)
Yes	2.9%
No	93.3%
N/A	3.8%
Total	**100.0%**

Source: Storm Financial Survey 2009

The overwhelming majority of clients believed that their Margin Lender had an obligation of duty of care to contact them before selling down their portfolio and closing down their Storm funds, in the circumstances where they were not in dispute with their Margin Lender (92.8%).

Table 33: Do you believe that, in the circumstances where you were not in dispute with your Margin Lender, that they had an obligation of duty of care to contact you before selling down your portfolio and closing down your Storm funds?

Response	Percentage (%)
Yes	92.8%
No	3.9%
N/A	3.4%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

Just over one in four clients claimed to have a Margin Call in the time that they had a Margin Loan (25.4%).

Table 34: In the time that you had a Margin Loan, did you ever have a Margin Call?

Response	Percentage (%)
Yes	25.4%
No	73.6%
N/A	1.0%
Total	**100.0%**

Source: Storm Financial Survey 2009

Of those who experienced a Margin Call in the time that they had a Margin Loan, most indicated that their bank advised them that they were in Margin Call (62.7%).

Table 34a: If yes, did your client adviser or the bank advise you that you were in Margin call?

Response	Percentage (%)
Bank Adviser	62.7%
Client Adviser	33.3%
Both	3.9%
Total	**100.0%**

Note: Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

Additional Survey

Another survey was sent to Storm Financial clients, following the distribution of the first survey questionnaire to collate additional information. A total of 314 responses were received. A copy of the survey questionnaire can be found in **Appendix A**.

The majority of respondents indicated that the Margin Lender sold down their investments when it reached the LVR of 90-100% (24.4%), followed by 100-110% (19.5%).

Table 1a: At what point did the margin lender sell down your investments LVR%?

LVR%	Percentage (%)
40-50	0.7%
60-70	1.3%
70-80	3.3%
80-90	8.3%
90-100	24.4%
100-110	19.5%
110-120	7.9%
120-130	3.3%
Other *	31.4%
Total	**100.0%**

Note: * Other comments received include the date when margin lender sold down investments
Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

As can be seen, more than half of all respondents had the Margin Loan with the Colonial Bank (55.4%), followed by Macquarie Bank (35.6%).

Table 2a: Which financial institution did you have the Margin Loan with?

Response	Percentage (%)
Colonial*	55.4%
Macquarie	35.6%
CBA	4.0%
St George	2.2%
NAB	1.5%
Bank of QLD	0.6%
BT Financial	0.3%
MLC	0.3%
Total	**100.0%**

Note: Colonial Bank: includes colonial margin lending, colonial geared investments, colonial first state

Multiple response format – respondents are able to nominate more than one answer
Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

The majority of respondents indicated that if they borrowed against the home loan, the residual debt that they would still have to repay the loan would be approximately $200 - $399,000 (50.0%), followed by $400 - $599,000 (18.1%).

Table 3a: If you borrowed against the home loan, what is the residual debt that you still have to repay the loan?

Response	Percentage (%)
0- $199,000	11.0%
$200 - $399,000	50.0%
$400 - $599,000	18.1%
$600 - $799,000	9.8%
$800 - $999,000	2.0%
$1- $2M	7.9%
$2- $4M	0.8%
$5M +	0.4%
Total	**100.0%**

Note: Colonial Bank: includes colonial margin lending, colonial geared investments, colonial first state
Multiple response format – respondents are able to nominate more than one answer
Source: Storm Financial Survey 2009

As can be seen, the Commonwealth Bank conducts the majority of home loans for respondents (40.7%), followed by the Bank of Queensland (18.9%) and ANZ (9.9%).

Table 4a: Which Bank conducts your Investment Home Loan?

Response	Percentage (%)
CBA	40.7%
Bank of QLD	18.9%
ANZ	9.9%
NAB	9.6%
N/A	7.9%
Westpac	6.0%
Suncorp Metway	3.6%
St George	1.0%
QLD Country Credit Union	0.7%
Aussie	0.3%
Macquarie	0.3%
Challenger	0.3%
Citibank	0.3%
Colonial	0.3%
Total	**100.0%**

Note: Multiple response format – respondents are able to nominate more than one answer
Proportion may not sum to 100.0% due to rounding
Source: Storm Financial Survey 2009

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