

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates 25-26 February 2009

Question: aet 14

Topic: Storm Index Fund

Hansard Page: Written

Senator WILLIAMS asked:

1. *In December 08, CGI unilaterally shut down the Storm Index Fund leaving many investors in negative equity, in other words, no way of recovering their losses. Investors were left with a Margin Loan Debt and a debt on their housing loan, as self funded retirees they can never repay these loans.*
Has ASIC examined the reason why the Index Fund was shut down, was it because of a system failure by CGI?
2. Who authorised the shutting down of the Index Fund?
3. Did the CGI /CBA do any sort of impact study regarding the consequences for Investors before the Index Fund was shut down leaving many Investors with negative equity?
4. *On 8/10/08 Storm advised Investors to convert to cash on a “blanket basis”. We understand this resulted in an investigation into Storm by ASIC. As a result of this investigation, Storm has claimed it was “gagged” by ASIC at a crucial time when markets were at their most volatile.*
 - a) Did ASIC Issue Section 19 on Storm?
 - b) Did ASIC give instructions to gag Storm, if so what were the instructions?
5. Was ASIC aware that Storm was telling Investors from Oct 08, they were gagged by ASIC , if they were, and ASIC had not gagged Storm, why didn't they correct Storm?
6. *Following the investigation by ASIC from Oct 08, Storm was allegedly given a “Clean Bill of Health” by ASIC.*
How is it possible that Storm could have been give a “Clean Bill of Health” but within 8 weeks Storm appointed Administrators?
7. *ASIC has been wide sweeping powers to protect Investors from the very scenario Investors are now facing. The model used by Storm and the CBA appears to be inherently dangerous involving double leveraging for unsophisticated investors. ASIC appears to have been “Asleep at the Wheel”.*
What level of responsibility will ASIC assume for the debacle that has unfolded?

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates 25-26 February 2009

8. Will ASIC be subject to compensation claims for its apparent lack of due diligence in both prudential examination of the Storm model and the lack of "Duty of Care" by the Banks, principally the CBA?
9. If ASIC had insufficient powers and or resources to avert this financial disaster for thousands of investors, what powers and or resources does it need?

Answer:

1. ASIC is investigating how Storm client's margin loans and portfolios were managed following the market downturn in late 2008. These investigations are still continuing and, as a result, ASIC cannot comment further at this time.
2. As outlined above, ASIC's investigations are continuing and we therefore cannot comment further at this time.
3. As outlined above, ASIC's investigations are continuing and we therefore cannot comment further at this time.

4.

- a) ASIC has used its powers to examine persons of interest as part of the Storm investigation under section 19 of the ASIC Act 2001.
- b) ASIC did not give instructions to gag Storm.

As part of the investigations we conducted in the week commencing 15 December 2008, ASIC became concerned about the advice Storm was continuing to provide to clients who were in negative equity to the effect that they did not need to meet their margin calls or repay their indebtedness because the banks were at fault. ASIC was concerned that this advice was coloured by the collapse of the Storm model and that clients were better off seeking independent advice about their affairs. ASIC sought to prevent Storm continuing to give what is regarded as potentially conflicted and incorrect advice to Storm clients in a negative equity position by way of an enforceable undertaking.

On or around 18 December 2008, following communication of our concerns that we thought this advice was inappropriate, Storm said it would cease contact with all its clients over the Christmas period rather than enter into the enforceable undertaking. Such action had not been previously requested by ASIC and was a decision made by Storm.

5. No. ASIC was not aware of this until the issue was raised by this Committee.
6. ASIC commenced its initial enquiries into Storm in October 2008. As a result of that work ASIC commenced a formal investigation on 12 December 2008.

ASIC has not, at anytime, issued Storm Financial Limited with a "clean bill of health".
7. Storm was giving advice about margin lending, which is not regulated under the Corporations Act. ASIC was concerned that margin lending was unregulated

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates 25-26 February 2009

and recommended to the Productivity Commission in February 2008 that margin lending should be regulated. The Government has announced reform proposals to regulate margin lending under the Corporations Act and ASIC is working with Treasury on these reform proposals.

The Act does, however, provide protection to retail investors through:

- setting a minimum standard of advice – personal advice must be (a) based on reasonable inquiries and (b) appropriate for the client, having regard to the client's circumstances;
- placing an obligation on the adviser, before giving any advice, to determine the relevant personal circumstances of the client, and make reasonable inquiries about those circumstances;
- rules for managing conflict of interests inherent in the advisory model (e.g. fee incentives skewed towards recommending investment into funds being managed for the planner).

Whether Storm complied with these obligations is the subject of our ongoing investigations and we therefore cannot comment further at this time.

8. ASIC does not accept the premise in the question that ASIC has failed to act with due diligence. The question also suggests some misunderstanding that ASIC has a role as a prudential regulator; ASIC has no such remit.

We are looking at the role played by the banks in the affairs of Storm.

ASIC also notes that ASIC cannot be liable in damages for any action taken by it in good faith in the course of its duties: see section 246 of the *Australian Securities and Investments Commission Act 2001*.

9. Whether regulatory reform is required in this area is a matter being considered by the Parliamentary Inquiry launched by Bernie Ripoll MP, Chair of the Parliamentary Joint Committee on Corporations and Financial Services on 26 February 2009.