

SUBMISSION T0:

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
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Australia

FROM:

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INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES IN AUSTRALIA

INTRODUCTION (Page 2)

TERMS OF REFERENCE

1. **(Page 3)** The role of financial advisers
2. **(Page 4)** The general regulatory environment for these products and service
3. **(Page 5)** The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;
4. **(Page 5)** The role played by marketing and advertising campaigns;
5. **(Page 6)** The adequacy of licensing arrangements for those who sold the products and services;
6. **(Page 6)** The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served;
7. **(Page 6)** Consumer education and understanding of these financial products and services;
8. **(Page 8)** The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and
9. **(Page 8)** The need for any legislative or regulatory change.

INTRODUCTION

My defacto and I were clients of Storm Financial for two years. During that time we invested considerable sums of money on the advice of Storm Financial and are now, like many others, in a state of shock at the sudden and inexplicable collapse of that organization.

We are presently seeking legal advice with regard to our dealings with Storm Financial and the Banks that financed us through Storm. However, before we proceed any further with litigation, we feel that it might be prudent to await ASIC's report on Storm Financial and the other financial bodies that were allied with them.

I believe it is pointless to detail in depth our dealings with Storm Financial because our tale is similar to many others that you have heard. Suffice to say that we have lodged claims with Worrells, and we will be highlighting our concerns about the way Storm Financial has handled our financial affairs to ASIC.

I will therefore address my remarks to the terms of reference under which the Committee was formed. From time to time, I will mention Storm Financial and the banks we have been dealing with when such is relevant.

I feel it worth while at this stage to state my background in business because it will allow you to gauge the depths of my business experience and give some credence to my comments.

I was employed in international logistics management for some thirty-five years. During that time I held many positions in overseas freight forwarding around the world. – International Freight Manager for Kuehne & Nagel in London - State Manager for Lep International in Western Australia, - General Manager for all Lep International's operations in the Philippines - General Manager of the Brambles-Steamships' Joint Venture in Papua New Guinea are just a few in point.

In addition to this, I have also worked for the Government in Chiefly Square, Sydney back in the eighties. During that period I was instrumental in constructing the "Sales and Marketing Plan" for the Transport and Storage Division of NSW that had an annual turnover of some \$122 million. I also redesigned the Registry and Recruitment areas of DOLGAS as it was known in those days. You can see, therefore, that I have both private and public sector experience.

Before addressing the Committee's Terms of Reference I will comment on something that is germane to the issue at hand but does not seem to appear in these terms. My question is, "Just how qualified do financial advisers have to be in order to give financial advice to the public?" Up to now, we, the public, have always assumed that people that set themselves up as financial advisers are suitably qualified. I am now told that their qualifications fall well below those demanded of accountants? If this is so, we have a situation where so-called financial advisers operating out there that have little or no accountancy background or formal accountancy qualifications.

I am further informed that qualified accountants are restricted in any advice they can give their clients relating to financial investing. This means that, in essence, qualified

accountants (the best people to be giving financial advice) are restricted when it comes to giving their clients' investment advice, but anyone else with limited financial experience can call himself a financial adviser and ply his trade accordingly.

Am I missing something here?

I suggest that the Committee investigate and established what qualifications financial advisers presently require, and whether such qualifications are sufficient to give them the capacity to provide an effective service to investors. It should also be ascertained just how liable individual financial advisers are for their own actions.

Whatever, something needs to be done to regulate the industry so "cowboys" are not allowed to work within a system that openly encourages them to foster.

Now for your Terms of Reference:

1. The role of financial advisers

This needs to be quantified by people qualified and experienced in accountancy and financial matters. They are the best judges of the issues at stake and they can recommend effective safeguards to protect the public from the Storm Financials of this world. By the way, how qualified were the financial advisers of Storm Financial whose reckless advice affected the lives of so many people?

I presume that your Committee is comprised of people that are qualified in financial affairs and can make informed and effective decisions in this respect. In my opinion you should be seeking outside solutions from accounting institutions in the private sector as well. We, the public, with no disrespect intended, need a "reality check". During my time spent working in the public sector, the subject of accountability did not figure prominently. The culture within the public sector does not lend itself to this. The private sector is set up with accountability in mind. Therefore, it seems logical to me that private sector solutions rather than public sector ones are called for. You need outside expertise to assist you in formulating the future role of financial advisers. My suggestion is to employ outside consultants qualified in accountancy and financial matters to answer the issues at hand; namely,

(A) What should the role of a financial adviser be?

(B) What formal qualifications should be mandatory for financial advisers to obtain before they can give financial advice to the public?

2. The general regulatory environment for these products and services

Because Storm Financial is the latest in a long line of financial institutions that have collapsed over recent years, and one that affects me personally, I will focus my attention on them.

In Worrells' "Report to Creditors" the following comments regarding Storm Financial have been stated:

"A financial snap shot of the Storm Group taken at 30 June 2008 provides a very positive view of its financial position. In regard to the year ended 30 June 2008 the Group:

Earned gross revenue of \$69.9 million, which was an increase of nearly 57% over the prior year.

Recorded a net gain in value of \$7.08 million from assets available for sale.

Disclosed a profit before tax of \$37.5 million, which represented an increase of 263% from 2008.

Had net assets of \$13.72 million

Had cash and equivalent resources of \$24.9 million

It also appears that at that time the Group had excellent relations with its bankers and clients. Further, internal marketing reports submitted to the board of directors suggested that the "pipeline" of potential clients remained healthy, and consequently an ongoing income stream could be anticipated. And yet, just over six months later, Storm was insolvent and had appointed Voluntary Administrators, which culminated in a cessation of business, the Commonwealth Bank of Australia (the Groups bankers) had appointed Receivers to take control of most of the Group's assets and many clients held Storm liable for losses on the share market that they had incurred amounting to many millions of dollars.

The initial catalyst for the dramatic reversal of Storm's financial position was, without a doubt, the very large and sustained drop in the Australian share market. Whether the company could have withstood the drop in the share market with the assistance of its bankers; whether the investments recommended by Storm to its clients were appropriate in most cases; whether the Fund Managers managing client investments acted appropriately and whether the actions of Storm and its directors following the drop were appropriate, are all issues that have been called into question. They are also issues which will require detailed and sustained inquiry, perhaps with the assistance of the courts, before a final judgment can be made."

What does this tell us? Can we really call Storm Financial a bunch of "cowboys" when they were operating in an environment that on the surface appears to be perfectly normal? I have no doubt that Michael Cassimatis is a clever man who used the system to his advantage. There is a saying in business that "loose leads to abuse." The way Storm Financial carried out its business was questionable but the powers that be, namely ASIC, do not appear to have been aware of this. In all fairness to them, ASIC probably doesn't

have the resources to investigate any company until something occurs that alerts ASIC to the problem.

Storm Financial, like many others, realized this and worked the system accordingly. Therefore, if the Storm Financial debacle tells us anything, it is that there is something wrong with the system as it stands. It is apparent, and has been for some time, that the regulations currently in place in the market place do not provide the necessary safeguards to protect investors.

Michael Cassimates, Chris Skase, Alan Bond to name only a few contemporaries seemed to thrive on loopholes in the existing regulations. When such characters get into trouble, they suddenly rush to divest their assets to willing relatives and beat a hasty retreat to the nearest airport. We, the public, despair because situations such as these are allowed to exist within the body of the law. The solution is simple enough. Find out where the loopholes exist and fix them. If the Government hasn't identified them by now it never will!" And for goodness sake, make the punishment for transgressing fit the crime.

How does that saying go? "If we don't learn from our past mistakes, history is doomed to repeat itself."

3. The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;

Storm Financial assured us that all fees obtained by them from any financial institutions it was dealing with would be funnelled back to us. Storm Financial was to be remunerated solely through the fees we paid for services rendered. Fees, I might add, that were among the highest in the industry. The fact that we paid Storm fees in advance and such fees were paid out of the margin fund thereby effectively increasing our margin loan borrowings and subsequent margin loan interest fees was lost somewhere in the detail.

Financial advisers should be made to apply a standard set of industry fees that are transparent. Such fees should clearly state what they are for and there should be no up-front fees allowed. That is, fees applied for services rendered in the future. We paid Storm Fees for future services that are no longer available. This should be a lesson for the industry at large.

4. The role played by marketing and advertising campaigns

You need to look more closely at the issue of false advertising. Storm made a number of claims in its advertising and its documentation including its statement of advice (contract) that were misleading and misrepresentative. I will be writing to ASIC following this submission to you and will be highlighting some of these. I'll send you a copy of my letter so you can ascertain for yourselves what Storm asserted. You can then be the judge of whether they stepped outside the boundaries of appropriate behaviour.

5. The adequacy of licensing arrangements for those who sold the products and services

I am not qualified to give an opinion on this. However, it is clear that this aspect needs to be looked at closely. My aforementioned comments regarding suitable qualifications must figure in the licensing arrangements somewhere.

6. The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served.

There should be an independent body that can vet proposals the public receive from financial advisers. If accountants are permitted to give this advice, then the answer is obvious. We must make sure that accountancy firms are able to fully advise on matters of this nature and are not restricted by red tape. I will be interested to learn what restrictions qualified accountants work under when advising their clients in matters such as these.

7. Consumer education and understanding of these financial products and services

In W. K. Lawson's submission to you he states:

"The real issue with those that have lost money through Storm investing is how many sought an independent review of the Storm Financial projections? Very few I would guess. It would seem almost all broke a golden rule of investing, "Do not put all ones eggs in one basket". Many would argue also don't invest what you can't afford to lose and once the home is paid off... keep it debt free or at least keep other assets that will pay off the debt should such action become necessary.

I am a Chartered Accountant who reviewed early in September 2008 the assumptions behind the Storm proposals at that time. They were unrealistic in projected growth in the share market, there were to be no realisations for 5 years. This latter raised the question, how was a retiree to get income/cash flow for living?? Not from income of the investments as that was taken by the Storm fee and ongoing interest on the margin loan! When these items were pointed out to my client he had no hesitation in deciding to NOT GET INVOLVED with Storm Financial .

How can you protect people from themselves? How do you prevent greed?

Maybe if we had Mr. Lawson around at the time to give us advice none of this would have happened. However, with respect to Mr. Lawson, his assertion that Storm's clients were motivated by greed is to say the least, presumptuous. We, for our part, wanted a secure investment portfolio that would grow over time. Storm had a reputation for doing just this. Whether that reputation was deserved or not is another story altogether.

Mr Lawson's remarks do, however, serve to highlight the gulf that exists between laymen and professionals. Laymen are people that are not versed in a subject such as financial investments. Professionals are people that should be well versed in their particular field and be capable of explaining in layman's terms what is involved. Unfortunately, I've met very few professionals that possess this ability.

Rightly or wrongly, we, Storms' clientele, assumed that we were dealing with a professional body and were receiving sound financial advice. Indeed, we had no reason to believe otherwise. I, myself, am not exactly naïve when it comes to accountancy having been trained in financial accounting in relation to company management. The problem was that the numbers presented to us by Storm seemed to stack up. The concept itself was an ingenious one. We would invest in the market place on a broad front. This meant that if any one company collapsed, we would have a fail-safe system in place. Namely the broad based market that could support isolated collapses would serve as our fail-safe. Storm further claimed that the "trigger-points" they had established for our portfolio would guarantee that our assets could never be seriously threatened.

No one imagined for a moment that the total market would collapse along a broad front. Certainly, Storm Financial did not when they originally came up with such a plan. The system would still have worked if Storm had acted on the "trigger-points" ratios because there would have been time to withdraw our investments and preserve our assets in part. Storm's failure to act in this regard, for whatever reason is inexcusable and makes it culpable.

Much of Storm's financial model was obscure. We were shown many slides and projections but Storm's actual strategy was never really diagrammed. If it had been, we would have all seen that it was an unacceptable risk with little or no real advantage in monetary terms. By the time we had an inkling of this we were hooked into the system. If financial matters are suppose to be open and transparent then Storm Financial failed its clients miserably in this regard. We admit that we were blinded by the hype, high profile, so called substance of the company and financial models presented. In that regard, Storm Financial had no equal in presentation and style.

The issue of consumer education and understanding of the financial products and services on offer is a subjective one. This depends on the literature available and the financial adviser's ability to outline a financial plan in terms that are easy to understand. In fact Storm were quite good at presenting things in laymen's terms. They were just short on detail.

Then again, perhaps we are looking at this from the wrong angle. I believe you should be focussing less on consumer education and more on the regulating of financial advisers and the type of schemes they currently employ. We, the public, need to be protected from ourselves. Mr. Lawson is absolutely right about that! We can only be so protected if we have financial bodies that are regulated and monitored on a regular basis. Internal audits such as the ones carried out at Storm Financial should be scrutinised to establish why a profitable organization could go "pear shaped" in a matter of months. Okay! We know the markets went down but why did this have such a catastrophic affect on Storm Financial? The answer seems clear enough. Storm did not carry the asset base and reserves needed to "ride the storm." The pun was intentional.

8. The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and

I believe that the issue of professional indemnity insurance is critical to this debate and serious reforms need to be undertaken to ensure that investors using financial institutions are covered by a mandatory insurance policy. Further, the insurance cover should be broad in scope and must allow for a recovery percentage of the investor's asset base. Naturally, you cannot guarantee that markets will not fall or share portfolios will remain intact. You can, however, ensure that clients of financial institutions are guaranteed some degree of protection if their asset bases are eroded away by malpractice.

If financial institutions operate financial buffers or trigger points they should be made responsible for warning clients when danger levels are reached. If they fail to do so, they need to be made liable as a consequence. Financial advisory organizations should automatically insure all clients against loss due to negligence or tort. One can argue that professional indemnity insurance covers this, but is it currently a requirement and what does it cover? An important point is also the extent of coverage in monetary terms.

We understand from the Worrells report that Storm did carry professional indemnity insurance. This needs to be examined in light of Storm's collapse to see where it best serves storm's clientele and where it does not. If it fails as a true insurance vehicle, then its failings should be noted and a new type of insurance cover developed for future contingencies of this kind in the industry.

We, for our part, have a clear case of breach of contract because Storm failed to implement action once the agreed trigger points had been reached which led to negative equity in our share portfolio. We also have a case for "misrepresentation" because we were misled into signing the original Statement of Advice.

Before closing on the subject of insurance, might not a form of government insurance be in order? All financial institutions could be made to contribute which would ensure that financial disasters such as the Storm one can never occur again. I am certain clients would not be averse to having this contribution included in their fees.

9. The need for any legislative or regulatory change

On 16 March 2009 the Senate agreed that the following additional matter be referred to the Parliamentary Joint Committee on Corporations and Financial Services as part of that committee's inquiry into financial products and services in Australia, adopted by the committee on 25 February 2009 for inquiry and report by 23 November 2009.

The committee will investigate the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses.

This is excellent news because it takes the onus off us to pursue the banks. Any legal action taken by us as individuals would be costly and the Banks know this.

Are the banks partly to blame for the demise of Storm Financial and the losses that occurred as a result of this? That's for the committee to establish. We can only state the

facts as they relate to our personal involvement with the Bank of Queensland who gave us a housing loan and the Macquarie Bank who gave us a margin loan. Both loans were obtained for us through Storm Financial who had advised us that this was the best course of action to take in order to grow our investment portfolio. As it turned out, this was the worst possible advice because it was a high risk strategy that left us exposed to any major downturns in the share market.

Have the banks acted inappropriately when dealing with us and other Storm clients? Again, that is for your Committee to determine. We can only tell you this:

We obtained a loan on our house through the Bank of Queensland and Storm Financial arranged this loan. Assets were overstated by Storm and we were not privy to the final documentation that Storm lodged with that bank. In other words, we signed blank forms that were completed and lodged by Storm. At no time did we ever meet with an officer of the Bank of Queensland.

Further, we instructed Storm last July when the rate needed re-fixing that we wanted a variable rate. Storm went ahead and requested a fixed rate. The Bank of Queensland now want more than \$18,000.00 to convert back to variable.

My partner's sister also had the same experience when dealing with Storm. I suggest, therefore, that the Committee look closely at the relationship Storm had with banks that extended housing loans to clients through Storm Financial. In particular, the paperwork involved, fees that were paid to Storm by the banks for obtaining loans, and the value of the clients' assets declared to the banks by Storm. I suspect that you will find irregularities in every area.

The margin loans Storm's clients obtained from the banks were the real cause of financial ruin for many. By the time margin recalls were made by the Commonwealth Bank and Macquarie, clients were already in negative equity.

I am of the mind that Storm Financial induced its clients to take out margin loans so it could increase its bottom-line. Storm's advice was both reckless and self seeking. It ultimately disadvantaged the borrower and placed the clients' portfolios at risk. At this point Storm Financial crossed the line and became "cowboys"!

We were dealing with Macquarie Bank rather than the Commonwealth Bank but there seems little to choose between them. It is interesting to note what Macquarie's trading conditions in respect of margin calls state:

5. Margin Calls

5.1 If at any time the Total Loan Balance exceeds or, in the Bank's opinion, is likely to exceed, the aggregate of the Market Based Limit and the Buffer, then the Bank may in its discretion require the Borrower to pay to the Bank a sum of up to the amount ("the Margin Call") by which the Total Loan Balance exceeds or in the Bank's opinion is likely to exceed, the Market & Limit (together with any costs incurred by the Bank in respect of such a payment).

5.2 The Borrower shall comply with any Margin Call by 2pm on the third (3) Business Day following the Margin Call.

5.3 The Bank may, as an alternative to the payment referred to in Clause 5. 1, at its sole and absolute discretion, accept additional security over property which in value and in form is acceptable to the Bank as security for the due and punctual performance, fulfillment and observance of the obligations the Borrower and the Securities Owner under this Agreement with the intent that the Total Loan Balance shall not exceed the Market Based Limit.

5.4 If the Borrower elects to lodge, or causes the Securities Owner to lodge with the Bank, further Eligible Securities to be held subject to the term of this Agreement, including the terms of Clause 12, in satisfaction of the Margin Call, the Borrower or the Securities Owner shall lodge or cause to be lodged with the Bank all such Eligible Securities, or such other documents as the Bank may require. All such Eligible Securities lodged with the Bank will form part of the Secured Property for the purposes of this Agreement. Such lodgement must occur by 2pm on the third Business Day following the Margin Call.

5.5 In the event that the Borrower or the Securities Owner provides cash by way of additional security under this Clause 5, the amount must be provided to the Bank in cleared funds by the time specified in Clause 5.2.

5.6 Any amount deposited under Clause 5.5 may, in the absolute discretion of the Bank, be held in the Deposit Account or applied to the Total Loan Balance. The Borrower and the Securities Owner shall not be entitled to withdraw, charge, encumber or otherwise deal with the Deposit Account until all of their respective obligations to the Bank have been satisfied in full. The Deposit Account shall be a non-interest bearing account and shall otherwise be subject to the terms of the Agreement.

5.7 Without limiting the Bank's rights following a Margin Call, if at any time the Total Loan Balance exceeds the aggregate of the Market Based Limit and the Buffer, the Borrower and the Securities Owner irrevocably authorise the Bank (and its officers and agents), as their respective several attorney, to sell or redeem (at the Bank's discretion) all or any part of the Secured Property as would produce sufficient funds to enable the Borrower to satisfy a Margin Call. If it becomes necessary to sell Securities which are listed for quotation on the ASX, such Securities may be sold through any broker nominated by the Bank at the broker's prevailing private client brokerage rates.

5.8 The Borrower is responsible for monitoring the Total Loan Balance and the Market Based Limit and is liable for payment of any Margin Call at the time at which the relevant Margin Call arises, irrespective of when or whether or not any notice to pay a Margin Call is given by the Bank.

Straight forward enough, one would think! I've no doubt that such conditions fall within the guidelines laid down. Do such trading conditions deflect the Bank's responsibility however in respect of its clients? Clause 5.8 is of particular interest, "*The Borrower is responsible for monitoring the Total Loan Balance and the Market Based Limit...*"

On closer examination of the margin loan we took out with Macquarie it becomes evident that the only ones who benefited from the margin loan were Storm Financial and the Macquarie Bank. Storm was paid its fees up front from the margin loan and the Bank received its interest every month. Basically, the loan was feeding on itself as soon as shares began to drop in price We were paying interest not only on the original loan but also on Storm's fees as they became part of the loan.

Storm opened a separate Macquarie Cash Management Trust account on our behalf from which we had to pay the housing loan and our living expenses. The original intention of this CMT account was that it would act, in part, as a cash reserve. However, it did not have the capacity to be such because it was constantly being drained.

In effect the Storm Financial Model had no real substance unless the markets continued to climb at a significant rate. Storm Financial became an organization built on sand and when the markets reversed the outcome was financial ruin for Storm's clientele.

When you investigate the banks' role in this affair, I suggest that you examine the following areas:

(A) Margin Loan Ratios

If margin loans are taken out for the purpose of investment, then the ratio should be based on the true owner's equity. By this I mean that if a portfolio has been inflated by borrowings that include substantial fees (in our case, Storm Fees) and margin loan interest that was also substantial, then the margin loan blows out. As a result the ratio between the total margin loan and the true owners equity becomes degraded and the actual position of the loan is obscured. The result of all this – negative equity!

(B) Payments made to Storm by the Banks that were never declared to Storm's clients. I'm not saying these existed but it would be prudent to examine this area anyway. Secret commissions or the like would be just another breach in our contract with Storm that is already beginning to look like a colander.

(C) The Banks' responsibility in relation to its dealings with clients and its billing policy. You can state what you want in your standard trading conditions but whether those conditions stand up in a court of law is another matter. I have no doubt that the banks have a team of lawyers advising them in this regard but the issue of "responsibility" never goes away. These questions need to be answered:

- I. How responsible were the banks in Storm's demise?
- II. Did they take the time to establish the true assets worth of their clients or did they rely solely on information from Storm? ?
- III. Did they have a "duty of care" to warn clients well before the margin loans went into negative equity?

The Bank approach to billing should also be looked into because this is a bone of contention at the moment with us. When we paid out the margin loan in December we were given a final figure by Macquarie that we duly paid. Later, we were informed that we owed a further \$2,386.61 because someone in Macquarie's banking division had made a mistake. Then we find that although we cancelled the margin loan in mid December, interest was applied to the end of the month. How can we be paying interest on a margin loan that no longer exists," we asked. "Because it takes so many days to process" was the response.

We are still waiting to hear from Macquarie Bank regarding an interest payment charged to our account that, we believe, has been doubled up. There is an impression in Australia that Banks are cold and heartless institutions that are only interested in making money. The attitude of the Bank of Queensland and Macquarie Bank only further serve to cement this view.

I hope my aforementioned comments and suggestions prove useful.
VICTOR AINSLIE - 25th March 2009