

28th July 2009

John Fuller

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

**RE: SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON
CORPORATIONS AND FINANCIAL SERVICES RE: THE COLLAPSE OF
STORM FINANCIAL**

My wife Danielle and I were both employed by Storm Financial in the Cairns office up until the time of the company's demise earlier this year. We also owned a shareholding in this company. My wife worked part-time for the group in reception / administration throughout this time. Danielle and I sold our share of an existing Cairns financial planning firm to Storm Financial in May 2007.

I was employed in the capacity of a licensed employee representative (financial advisor) with Storm Financial Cairns.

The few months leading up to Christmas 2008 was a transition phase from a period of normal business practices to a consistent pattern of irrational business behaviour. The latter, stemming mainly from two major banking institutions that shared the vested interests of a number of Storm Financials clients at the time. The banks involved - Macquarie Margin Lending and the Commonwealth Banks' volatile margin lending off-shoot, Colonial Geared Investments (CGI).

At a critical time in early November, shareholders were advised that a small group of senior employees (including our CEO) had been in negotiations with Storm's corporate lender (CBA) - attempting to negotiate on issues surrounding the ongoing financial welfare of Storm Financial and our mutual clients. We were advised that this meeting was productive. We were advised that the company was solvent and had suitable liquidity going forward. We were advised that additional corporate funding had been approved by the CBA and was at the ready - but nothing concrete had been transacted at the time. Storm had all approvals in place for funding from its corporate lender - but no money was ever released by the bank.

CBA moved the goal posts some time after this meeting. Obviously in serious discussions with its own top number crunchers, it decided to back flip on any pending

resolution with Storm Financial for its mutual clients. We were advised by email that this was now the banks new direction. Once this decision was enforced, normal business protocol between CBA/CGI and Storm Financial went out the window, all lines of communication between the bank and Storm Financial were extinguished by the bank and margin calls were all of a sudden being made direct to clients. The manner in which banking staff conducted themselves from then on with both Storm staff and clients was nothing short of disgraceful. The complete sell down of an entire Storm-badged index fund would also occur.

I was educated from the outset within Storm Financial that no client would ever receive a margin call direct from their margin lender. If maximum LVR's were breached or threatened, the margin lender would direct the call through Storm Financial and the problem would be dealt with by both bank and advisory body according to client position. In November / December 2008, direct margin calls to clients were coming thick and fast. CGI employees were also advised to relay to clients that it was Storm who was fully culpable for current client predicaments. In most cases, clients were given 48 hours to rectify their positions. The margin calls were bank scripted and routinely read out to clients over the phone.

At the time, Macquarie Margin lending was also calling clients to advise them of their portfolio position. Again giving client's unreasonable timeframes to rectify their positions and again placing the blame for their predicament squarely at the feet of Storm Financial. How either institution was able to accurately identify client positions at the time, in relation to LVR's to assess if buffers had been breached is beyond me. It would have been impossible for them to do so with any degree of accuracy given what I had witnessed in my dealings as an advisor with their margin lending websites in the latter part of the year.

Macquarie Margin Lending and CGI advisor websites were of little use to a Storm advisor throughout the latter part of 2008. Their systems were rarely up-to-date and LVR's were extremely distorted. I know of a colleague whose own LVR we were attempting to monitor displayed positive equity one day and massive negative equity the next on the CGI advisor website. Quite peculiar given the market was flat throughout the day of our investigation. I had to keep advising clients that I, their advisor, could not provide them with an accurate picture of their portfolio as the margin lender could not provide me with one. As far as I was aware, there was only one man at CGI responsible for all Storm margin lending portfolios.

CGI provided no warning to clients when they began selling down the Storm branded CFS Australian Share Index Funds. This occurred regardless of whether there was a prudential need to do so or not. The excuse offered at the time suggested that with such limited units in the index fund remaining after redemptions, it was becoming too costly to maintain. Some Storm clients found themselves removed from the marketplace when there was no logical or financial reason to do so. Others, who may or may not have been in call, were given no opportunity to remedy their positions and

had losses crystallised without any input. I was advised that Colonial Geared Investments provided Storm Financial with a 5 minute window to act before the redemptions began. Within this timeframe, I was also advised that Storm Financial had acquired a suitable replacement Responsible Entity (RE) to roll client funds into to avoid crystallising client losses. This transfer was subsequently denied by Colonial.

More pain followed when CGI decided to return their maximum LVR's and buffers on margin lending for Storm clients back to industry standards - with no notice to the client and minimal notice to Storm. 80% + 10 became 70% + 10. Any clients within the latter range before this decision now found themselves in margin call - and being called. The grandfathering clause that Storm Financial had in place with its lenders, and one that I was always proud to advocate to clients, had simply been made null and void by the bank.

It was my experience on a day-to-day basis in the latter part of 2008 that the CBA's margin lending product (CGI) along with Macquarie Margin Lending did not have the systems in place to deal with the extreme sharemarket volatility at the time. Their final solution was brutal – close ranks on anything / anyone to do with Storm Financial. In doing so, they didn't seem overly concerned about the effect these actions would have on our mutual clients. They inexcusably chose to abandon these clients at the very moment in which they were most vulnerable. 115 staff, most of whom were Storm clients also, were left without jobs as well. I was told that the CBA / Storm / client relationship had generated \$198m for the Commonwealth Bank in the fiscal year 2007-08.

Macquarie conveniently announced to the marketplace that they were selling their margin lending book around the same time. No surprises there.

Storm Financials entry into voluntary administration came as a direct result of the CBA calling on Storm's (the Company) margin loan facility as it had plunged into negative equity along with other client portfolios. It may surprise many that Storm (the Company) was also a client – advocating, and further practicing the same investment strategies not unlike many other Storm clients.

This issue of negative equity on some Storm client portfolios is confusing at the very least. If all margin lending products around the country failed their investors at the height of market volatility in late 2008, then all advisory firms who recommended the gearing product predominantly in their client portfolios and who practiced the same strategy would now be in, or close to administration also. I know of no other clients external to Storm Financial who have even mentioned the words “negative equity”- and this is for one simple reason – if their buffers were being breached, then regardless of the market turmoil of the day, “their” margin lending provider acted appropriately on client portfolios and “their” margin lending product served the

purpose for which it was intended. It's astounding that only Storm Financial clients have issues with negative equity and no other.

Many would also be aware of comments made at the time by CGI regarding their margin lending product being the sole responsibility of Storm Financial. If I'd have known this back then, I would have simply left my personal portfolio alone – along with those of my clients, allowed some to drift into margin call, allowed others to drift into negative equity, maintain a constant vigil over their cashflow in the interim, capitalise all client interest to their loans and simply wait for the market to do what it has always done in the past – RECOVER! By now, I and many of my clients would be still in the market, would have no crystallised losses, would be out of buffer, would be out of call – and ultimately, out of trouble.

The compliance team within Storm HQ were a hardworking group dedicated to the continued portfolio maintenance of all Storm clients. Storm had extremely efficient systems. I have no doubt Storm would have been the envy of many in the same space. The banks loved Storm's efficiency as well. In more rational times, it was a great comfort knowing that checks and balances were in place for all clients at all times regarding their portfolios via the margin lending websites and the open lines of communication between the margin lenders, equity lenders and the compliance team. I have no doubt that Storm's systems and staff held up in a more efficient manner, under extreme duress from external market forces throughout the times of severe share market volatility. The banks systems in relation to the Storm collapse did not.

As an advisor, I was gagged by ASIC from talking to my clients in the days leading up to Christmas 2008. All Storm advisors were. I was advised that any attempt to contact clients would result in penalty if I was to breach the restriction. They sent us home. Not a good look when the heat is on and clients are looking for direction amidst all the confusion. Regardless of what some perceptions are, all staff in Cairns fought for the financial integrity of all of their clients to the very end. No-one ran. I am thankful to SICAG and its co-chairs Mark Weir and Noel O'Brien for their pursuit of the truth in relation to this particular matter.

ASIC also had a choice to make around this time when advisor restrictions were put in place. The preferred option should have been to continue in allowing Storm advisors to interact with their clients. After all, concerned clients were ringing constantly, looking for direction at the time. Many were quite emotional also, given the media circus that was raging from the epicentre in Townsville and beyond. ASIC decided however to ban Storm advisors from any interaction. Not only could we not talk to geared clients, but that left the company with no advisors to communicate with some 11,000 other clients who may have had issues with the predicament of the company and their personal financial position at the time. The CBA and its spin doctors had cajoled the nation's top financial watchdog into an action that added further emotional pain for bewildered clients. It defies belief given the regulators primary mandate is to protect all retail investors and consumers in the financial

economy. It appears that without any investigating, ASIC simply took the bank at its word and shut us down.

The overall advice delivered by Storm Financial, standing alone, would not have been enough to cause the collapse of the company, its subsidiary companies and some client portfolios during the global meltdown. Suggestions from some corners pointing to the investment advice as ‘crumby’ also holds no credence, as the banks involved with Storm over the years would have severed ties long before now if they had deemed it to be so.

For the record, the advice provided by Storm Financial involved buying index funds utilising leverage (gearing / borrowing money to invest) if appropriate to client circumstances. In layman’s terms and in Storm’s case – buying the top 300 Australian Companies (basically, the Australian economy) on the Number One board of the Australian Stock Exchange and investing into each company at the weights that each of these companies sat in the market. Storm branded index funds were also fully indexed. Client portfolio weightings were adjusted automatically as the market weightings changed.

Political preferences aside, you would have to agree that investing in the Australian economy, long term, is a pretty safe bet. A non-default asset by any measure. Many advisory firms have differing investment strategies utilised to create wealth for their clients – but this was Storm’s. The historical annualised return of this asset (the Australian economy) over the past 100 years – approximately 12%-13%. How is this high risk–high return financial advice for long term investors? Compare Storm’s asset allocation strategy to those of Opes Prime, Westpoint, Fincorp, ACR and the like. There is no comparison when it comes to assets defaulting to zero. Yet, the media continually portrays Storms advice in the same light as these other companies. It is chalk and cheese stuff.

In light of the above, the only issue then that needs addressing is that of leverage.

Gearing into non-default assets has been around for many years and it will be around for many years to come. Those with equity loans against rental properties today are utilising a similar investment strategy but simply investing into a different underlying asset. The risks are similar – the value of property goes up and down too – and up more than down over time (volatility). It is however, less volatile in its exposure to the economic cycle, less liquid than shares and more physically attractive to those who desire the viewable, touchable nature of the asset – you just don’t see its exact value on a day-by-day basis as you do with shares on the 6.30 news every evening.

So the only real difference in this case, with regard to leveraging, is the concept of secondary lending or margin lending being applied to a share investment portfolio. A margin loan is a loan secured by a portfolio of shares. A common investment model / strategy used by many the world over. In short, each share (listed company) will have a maximum LVR applied to it by a margin lender dependant on how they view the strength of that share (listed company). In other words, does one company have a higher risk of default than another – the higher the ‘calculated’ risk of default, the

lower the maximum LVR. Most blue chip Australian shares have maximum lending ratios (LVR's) of approximately 65 - 70%. The Storm-badged CFS Australian Share Index Funds carried a maximum LVR of 80% plus a 10% buffer. This attests to:

- the strength of the underlying asset Storm was advising on,
- the high regard that the margin lenders associated with Storm held it in – and finally,
- the strength of the corporate relationship between the advisory body and the lender to allow such maximums.

On this basis, the investment model (gearing) is not flawed. It could also be argued that the advice advocated by Storm on which type of asset to invest in is not flawed. The only thing that has to hold up when the chips are down is the margin lending product being utilised – if utilised at all. If that fails to perform its fiduciary duty, like it did in this case, then the gearing model becomes exposed as it leaves primary (equity) loans and the security attached (the home) out in the cold. Especially, when negative equity comes into play.

With this in mind, the unprecedented falls on the Australian sharemarket towards late 2008 provided an opportunity for many institutions and institutional practitioners to test their own resolve by either continuing to endorse logical reasoning in the face of uncertainty or to act without lucidity. I believe there was no clarity in the banks decisions at the time with regard to the failure of their margin lending products. Add to this behaviour a simultaneous and then ongoing “death by media” campaign and the overall investment advice delivered by Storm Financial becomes flawed indirectly - or in this circumstance, it becomes guilty by association.

I believe Storm Financial would still be a viable entity today, but for the irrational decision-making behaviour and system malfunctions of the banks involved in the relationship. In collusion with the media, they assisted in promulgating the unfortunate position of Storm Financial – a position brought about, in part, by the dubious actions of one of the main protagonists – themselves. If the banks had not acted in such a way, Storm Financial would have almost surely been forced into downsizing its operations to accommodate the financial crisis. The company and its relationship with its business partners however, would have survived. There would have been casualties no doubt, given the massive financial and subsequent economic downturn, but not the carnage to the extent that we see today. Nowhere near it. No negative equity issues either for that matter.

I further believe operational survival would then have allowed Storm analysts the opportunity to fine-tune portfolio parameters on all client cashflow viability to re-factor past and evolving market anomalies (eg. global credit crisis). Yes, retirement portfolios would have come under serious scrutiny. This testing would not have been uncommon over the previous 30 years of client /portfolio management – as I am sure it is with other advisory firms in the same space. It would have simply been ongoing strategic and operational due process within Storm and its partners. The PI insurance may have been partly utilised for affected clients then, rather than having been made

totally obsolete given the extent of the fallout now. The point is, through its own self-preserving actions, the bank denied Storm Financial and its mutual clients any opportunity to rectify.

Not once throughout my tenure as an advisor with Storm Financial did I use the word “stormified”. Clients in Cairns were always treated with the utmost genuine respect by all staff. I would argue vehemently with anyone who suggests otherwise. Contrary to media reports, I witnessed nothing sinister, nor did I see any dealings with clients that were unethical, immoral, illegal or dishonest. The work environment was innovative and challenging. I had absolute faith also in the compliance team within Storm Financial. I knew them well and can attest to their professional integrity.

Storm staff in Cairns, and I am sure elsewhere, were given less than one hour on a day in mid January 2009 to collect their personal items once administrators had moved in. The stealthily manner in which the administrators operated gave us no time to advise clients of the position the company was being placed in. We barely had time to place a message on the answering machine for clients before being escorted to the door just after midday. Many staff were clients of the company too, both young and old who have been given no choice either but to start again. All lost their jobs in an economic environment not conducive to successfully finding another one. Many staff also had immediate family, relatives and friends who also accepted Storms advice. This is not a push for sympathy but merely a statement to clarify that emotion, heart-ache and disillusionment has been deeply felt also from those who were employed within.

I have a healthy disrespect for certain elements of the media, the predatory behaviour of some financial advisory firms and those who have sat on the sidelines and formed their own baseless opinions of what transpired with Storm Financial. Some earlier comments made in some sections of the media regarding the Principals of the now defunct firm were absolutely disgraceful. I am not ashamed of the position I held with Storm Financial. This would only disrespect the many friendships I formed throughout my tenure there.

The reason for this debacle is systemic failure. All clients, whether they have defaulted or not, were let down by the failure of a system to display reasonable care towards the very people who afforded so many in the financial world their lifestyles.

For this reason, I sincerely hope they have their day in the sun.

Regards,

John Fuller

Personal experience with **CBA only**:

- We currently have a CBA Better Business Loan provided to us by the CBA prior to the proposed Storm Financial float.
- It was offered to some Storm employees after a CBA bank representative in Townsville saw an opportunity for Storm employees to raise personal capital for the then pending float of the company.
- They didn't want the money back when the float didn't fly – we were told we could use it however we pleased.
- This is a \$100K unsecured Business Loan with a 3 year interest only period.
- The loan structure was not made available to the open public.
- It was also offered to Storm employees by the CBA as a sweetener to Storm Financial in an attempt to win over their total corporate lending facility from another banking competitor.
- Storm's corporate banking business was always with Westpac previously.
- I am aware that other Storm employees were offered and accepted the same loan structure.
- Remember, these were business loans that the CBA provided, not **home / personal** loans. You would expect the bank would want unsecured money back pretty quickly under normal circumstances. It didn't seem to concern them greatly – the relationship with Storm was solid.
- I have confirmed that special approval from CBA Brisbane / Sydney would be required for an unsecured **business** loan for the lesser amount of **\$20K**.
- Approval of these loans would also have required special approval / policy from the banks credit department.
- \$100K unsecured business loans to wage earners just don't occur out there in the corporate world.
- I was brushed by a Townsville CBA representative to another in Sydney. To her, I had murdered someone. I expected as much. Being a former Storm employee hasn't done me any favours.
- These loans would have only been offered because of the CBA's close and vested interest in Storm Financial.
- They knew about the float, were very acquainted with Storm's business model and Storm's profitability.
- They would have approved these loans as a 'special matter'.
- Put simply, it was a VAS loan in disguise.

As a wage earner or self-employed, try going into a bank and requesting a \$100K unsecured personal loan with a 3 year interest only period attached. You will still here them laughing on your way out, as the electronic doors close behind you.