INQUIRY into FINANCIAL PRODUCTS and SERVICES in AUSTRALIA

Subject: STORM Financial

Submission Summary

ANNEXURES

Annexure A:

Communication from Storm to Bank of Queensland, 27 June 2006

Annexure B:

Communication from Storm to Bank of Queensland, 7 June 2006

Annexure C:

Comments and Observations on 'The Storm Statement of Advice (The Business of Making Money) and The Bank of Queensland Loan Application Document

Annexure D

The Business of Making Money (Statement of Advice) Financial Plan created for …………. and ………………

1. Introduction

At the risk of some subjectivity it is not entirely possible to address the issues we have itemized in our summary without referring to our own personal experience and current situation.

The personal and individual story of the journey to financial ruin is important and needs to be told, recognized and acknowledged, if for no other reason than for others – individuals, Banks, the Financial Services industry and its Advisors and other Regulatory Bodies - to learn from our experience.

However we sense that saturation levels could be fast approaching for observers who have not the intimate, shared and dreadful experience that such severe financial loss and its far reaching consequences – social, personal and psychological - brings.

So for the reader who has reached saturation point with the 'personal stuff' and wishes to get some hard core commentary and analysis we suggest you initially **'Pass GO'** and proceed directly to:

P 22 – 29 ANNEXURE C: ***Comments and Observations on 'The Storm Statement of Advice (The Business of Making Money) and The Bank of Queensland Loan Application Document.***

The comments observations alone in Annexure C should raise many disturbing questions in relation to the document given to us as our Statement of Advice and may encourage you to read the other 'hard core,' issues we have commented on such as – **LVRS, The Bank and their practices, The Double Mortgage etc** - as well the story of our STORM Financial experience.

Background

Our Situation and our story is by now a familiar one. We have suffered very significant and irrecoverable financial losses due to the collapse of STORM financial. We now labour under the chronic strain of a huge debt on our home, a debt that we cannot at our age ever hope to repay, and the impossibility of having to totally rebuild our financial situation which took the best part of 40 years to accomplish. Day to day it is a mentally and emotionally debilitating and destabilizing situation.

How we came to STORM Financial

For the better part of 12 years we had taken advice from our advisor and later a Storm Authorised Representative, Anne O'Neill.

In November 2005 she informed us that she had a very exciting prospect for us - one that would allow us to fund our retirement but also over time to build our wealth without diminishing the original investment – the now familiar and infamous STORM mantra of not eating our chickens!

During the course of further discussions in 2006 it was made very clear to us that she was convinced that our superannuation if managed in the normal way and left as was, even though our superannuation investments had been supporting us well to date, would not adequately fund our retirement and/or lifestyle and that this usual method of financing retirement could be a more risk prone strategy if markets fell and that we would be financially disadvantaged by not taking advantage of the STORM Strategy.

In brief, in August 2006, on advice which we believed to be appropriate, trustworthy conservative and safe (to us as retirees) we committed a total of $1,193,181.00 of our own equity – our combined superannuation, blue chip shares to act as additional security and a loan against our property - to the Financial Plan that STORM had created for us. Simultaneously and also with the aid of STORM, we took out a Margin loan with Macquarie Margin Lenders and Home Loan with the Bank of Queensland.

Our situation before investing the 'STORM way'

1. We had both retired. At this time. At the time of investing into The Storm Badged Challenger Indexed Trusts and taking out both the Margin Loan with Macquarie Margin Lenders and the Home Loan with the Bank of Queensland we had no income stream from employment apart from some casual income from part time work and so assumed that both of these loans must have been based on the predicted performance and returns of the investments and the assumptions underlying these.
2. We wanted to be self funded retirees, a position encouraged by the government. We had no extravagant plans for our retirement- just plans that were personally precious and important to us – to have time to now explore other areas of life and other interests, build and foster relationships within our community and re-establish friendships with those who shared our values, some holidays and perhaps some new furniture and some improvements to our bathrooms.

Prior to our commitment to the STORM investment we had:

- Debt free assets totalling approximately $1,193,181.00.These comprised our combined Superannuation of $622,181.00, unencumbered 'Blue chip' Shares of approximately $91,000 and our unencumbered property valued at $800,000.00 by The Bank.
- No debts.
- I retired from full time permanent employment in April/May 2006 and my partner retired in January 2005. Neither of us has been in the work force since retiring more than 3 years ago.
- At the time of our STORM Investment we were retired, a position we were encouraged to believe would be supported by our STORM Investment.

After the 'STORM'

On 9 January 2009 we received our last communication from STORM'S North Sydney Office advising that we should pay down our Margin Loan.

This advice was totally contrary to STORM'S previous advice of 8 October ("That funds are not to be used to pay down debt") so we were anxious to set up a meeting to discuss this. As we had had no response by Tuesday 13th January to our request we rang the North Sydney Office only to be told that we could not speak to our advisors as STORM was in the hands of the Administrators.

On 15 January 2009 we were officially advised by Macquarie Margin Lenders that it was exiting the business of margin lending having sold its margin lending portfolio to Leveraged Equities. As our loan was not included in this sale because it was a 'Storm Badged Portfolio' with an unacceptable LVR, we would have to either close out or refinance our variable and fixed margin loans before 25 June 2009.

We sought other professional and independent financial advice. This advice confirmed to us that we had no choice but to completely close out this loan.

Having no other financial resources whatsoever to fall back on we were forced to use all but 3.76% of our cashed up portfolio of Challenger Investments to pay down the loan of $1,949,420.00

We have been left with a relatively small and now ever dwindling amount of capital, a mortgage to The Bank of $480,000.00 against our home which we have been funding for the most part our savings as our earnings cannot always be guaranteed cover the monthly repayments and living expenses.

So, Our present our situation is.

1. I am 59 years of age and my partner is 61 years of age. Neither of us has been permanently employed since retiring more than 3 years ago.
2. Neither of us has yet been able to secure permanent full time employment, although we have some temporary and part-time work at present.
3. Commitment to full time employment is also difficult as my mother whilst generally in good health and independent increasingly requires more time and assistance to manage her daily life.

Our financial and asset situation is now very much diminished. Our position is irrecoverable.

Our entire superannuation and savings accumulated over a combined 71 years of work, good quality shares carefully purchased with after tax savings and money we had saved, have been swallowed up and lost through the unravelling of the Storm investment strategy.

4. We now have :
   - Some remaining cash, made up of the remnants of what remained after having paid back our entire MML of $1,949,420.00 and some savings.
   - Some shares approx $24,000.00 (market dependent)
   - An unmanageable debt of $480,000.00 to the Bank of Queensland and after paying break costs to the bank of $7,981.00 to move from a fixed loan to a variable loan now have repayments of $2,105.00 per month (instead of $3837.00 per month).
   - We have no buffer / safety net and are extremely vulnerable to outside interventions predictable or otherwise - interest rate changes, house repairs, medical happening etc - which can very easily, very quickly and profoundly undermine and erode our situation now unprotected by any reliable or substantial income stream.
5. Depending on what we can earn have we may receive part payments from Centrelink under 'Newstart Allowance' scheme.

Based on recent market appraisals from Local Real Estate agents we estimate that after repayment of the debt of $480,000.00 to the Bank of Queensland, legal costs that accompany real estate sales and purchases, stamp duties on repurchase and the advertising demanded by Real Estate Agents, we may just be able to afford a one bedroom unit, but of course will have to continue to try and secure full time permanent employment in one of the most difficult job markets on record at a time when we have now been absent from the work force for well over 3- 4 years.

With the best will in the world our losses are irrecoverable. We are financially worse off than we were 40 years ago and without the benefit of youth and time to recover lost ground.

2. Appropriateness of Advice and Information

The advice we were given was for a product which left us exposed to levels of risk that were unacceptable and inappropriate to our:

- Age and retired status
- Our financial situation
- Our risk profile

As Retirees

Insufficient depth of cash reserves

As already stated above we were retired at the time of investing in STORM. There was an increased risk to us as retirees with no other source of income or cash reserve outside of the Storm basket.

In our book *'The Business of Making Money '(Statement of Advice')* which was prepared for us as our Financial Plan it says that uncommitted cash reserves were an important component of the Plan. Despite this there was no advice or diligence to ensure that we should, as a safety net, also have cash funds outside of and unrelated to the 'STORM basket', available and set aside additional security – just in case.

From our asset and liability situation STORM knew we had no other funds of significance as all our finances went into the Storm Investment. There were some monies about $53K set aside as 'pending outlays' but this was really from our own original funds that we had contributed to the whole scheme.

Our Plan states that "Cash reserves of around $180,000.00 will be your primary form of protection from the effects of varying returns from you Share Investment..."

This was in fact the monies in our 'cash dam'. All this cash was already dedicated to the Plan and so could not be a source of security. It was already 'spoken for' as it was to be used to cover interest payments to the Macquarie Margin Lending, Bank of Queensland and for our monthly income (cash flow)

Our uncommitted cash Reserves

What we did not utilize from our monthly income of over $7000.00 per month, we saved as we did not live extravagantly.

We were not actively advised or encouraged to save or be conservative with our cash but our own instincts told us we should be preserving our cash long before the rather late advice from Emmanuel Cassimatis in late 2008 to be doing the same. In fact had we not been more frugal than we were – STORM was not 'big' on frugality and encouraged us to indulge - we would not have been able to pledge additional security to our Margin Loan.

In July 2008 we pledged a further $100K of our own savings as security against our Margin Loan to reduce the LVR to a safer level.

Experience

As we lacked any experience when it came margin lending and we did not have the real life hands on experience to assist us in grasping the main risks in relation to the debt borrowed –

that it could massively escalate if stock values fall .Whilst these risks were referred to in the 100 + pages we had to read to understand the strategy, we do not recall significant focus or detailed attention to this by our advisor. It was discussed, but the best way that we can describe these discussions is that the risks, even the worst case scenarios were minimized 'played down' and portrayed as being unlikely to ever happen. Only the positives were dwelt on and we were not knowledgeable or experienced enough to know at the time (2006) what questions we should have been asking or what issues we should have been more alert to or insistent in having clarified.

Before committing to the STORM way we asked many questions particularly in relation to the 'safety' of our house if the equity were used to help fund our investment – **see below '**<u>**Double Jeopardy Mortgage**</u>

We were constantly being assured that the strategy was so well engineered and managed that it would not ever fail – it had proven itself through all markets.

Personal Risk profile

We now understand that STORM'S investment strategy really was what is termed high risk although the 'Financial Plan 'sought to demonstrate that STORM's strategy had been stress tested and was therefore safe.
The STORM tome we were given to read in order to try and comprehend the strategy, describes, what we now understand to have been an extremely high risk strategy, and not one for the average person let alone a retiree.
We now know that margin loans and the risks they carry are only suitable for investors who are both experienced and who also have very significant uncommitted and available cash reserves.

<u>We were not experienced investors</u>. Whilst I had limited experience of purchasing shares with after tax earnings via a broker, n<u>either of had had any direct or practical experience with margin lending</u> and we feel that a much higher risk tolerance, than was reasonable for us as a couple, was assumed.

In correspondence to us from our advisor in 2005 my partner is described as a "Defensive/Moderate risk profile" and this was "based on our many discussions"

Clearly his profile was a poor match to what the STORM Investment Strategy really was – High Risk.
Given that 85%of our total superannuation which was invested into the plan was his and he had the majority share (65%) of our total equity taints even more the quality of our advice.

3. Our relationship with our advisor and the role of our advisor.

We liked our financial advisor and we had what we believed to be a good client/advisor relationship developed over the last 12 years or more years. Over a significant period of time she had advised our immediate and close family members and so we had every reason to believe and have confidence that her advice would always be tempered by a continued fiduciary duty to us.

Essential to our relationship was complete trust and belief that her advice and judgement in relation to our financial affairs had been and always would be in our best interests. We believed that she had always sought and provided solutions that were in our best long-term financial interests and had no reason to think that the 'new strategy' would not fall into the same category.

Our current situation has left us feeling betrayed and also saddened that someone whom we had trusted and whose advice and expertise we had for long accepted as been reliable, responsible and suitable for us and our client profile, took such a risk with our lives and our future financial wellbeing.

We were at a vulnerable point of our financial life and I was finding the work place and its culture increasingly stressful and unsustainable so we may have appeared 'ripe' for the STORM way and the retirement plan it could offer. Our advisor knew my feelings, because we had over the previous 18 months or so prior to 2006 engaged in discussions about work and changing attitudes to work that came with age.

We should shoulder some of the blame for our situation and hindsight is a cruel task master

However, we believe that our greatest fault was that we trusted in the recommendations and rationale offered to us by an advisor we had trusted for so long and so did not seek other opinions. It may have been mentioned that we could of course do this but we did not for the above reasons. i.e. our long standing trust our advisors recommendations.

Our other failing was to commit our entire life's savings to a strategy and a product the risks of which we had not fully comprehended and committed to an investment strategy which we had together with our advisors explanations, endeavoured understand from reading the large tome of some 100+ pages: '<u>The Business of Making Money'</u> which contained our 'Financial Plan' until 2022.

So ' en lieu' of complete understanding of the more obscure and contradictory elements of the Financial Plan we turned to trust in our advisors judgement, interpretations and recommendations and also to the comfort in having our decision normalised.

The whole STORM investment exercise appeared to us as something that both ordinary people (like us) and knowledgeable financial advisors committed to.

There was a sense of 'everyone singing the same tune'. It no secret (and often spoken of to evidence that the STORM Product was attractive) that STORM'S own staff, as well as advisors and their immediate family members, also had STORM Financial Plans.

We knew that our own advisor had borrowed to invest in STORM funds. Her own confident commitment to the strategy and her belief in its ability to provide a reliable income stream and simultaneously grow wealth probably contributed to our acceptance and initially overrode our doubts. And worst case scenarios, such as margin calls were so unlikely that we should not worry!

However with her increasing involvement with STORM and after the sale of her business to STORM, we increasingly felt, despite wanting to believe to the contrary, because it was incongruent with our trust and belief in our advisor and our ideas about her, that we were being 'sold to' rather given the best and most appropriate advice.

Even on the brink of losing everything, during the course of our last meeting on 17 December 2009 our advisor remained adamant that we would still have been far worse off if we had left our superannuation in place in the 'Navigator Funds' and that STORM would still serve us well!

4 STORM's failure to take initiative & respond appropriately; monitoring of LVR's and cash dam.

1. Taking investment steps on the cusp of the Global financial Crisis

On 11 August '07 we expressed in writing our concern about taking a recommended investment step.

We calculated that if we took this step we would be geared to what was for us an uncomfortable LVR of 71.4% if markets fell by the then optimistically predicted 15% as the world experienced the first ugly rumblings of the 'sub - prime' mortgage crises' surfacing in the USA.

We expressed our concern in a fax to STORM's head office in which we said that we thought it would be best to defer the step until we could be sure that, in view of these events and the press reports that this contagion would undoubtedly spread and that Australia would not be immune. We said in our fax to STORMS Head Office that we felt the timing of the investment of$188,788.00 may not be judicious or perhaps the best advice at that time given the predicted fallout and that we did not want to proceed with this investment step.

We were however told that Australia and the rest of world were quite safe and we would be quite OK and should proceed. Even without the benefit of hindsight this seems to have been either naive or ill considered advice given the closely wired and global nature of the world, its current banking systems and practices.

We should have heeded our own counsel.

2. Our monthly Income allowance

Many times we suggested to our advisor that we could actually take less income than what we were being 'paid' and that we had a preference for this to be changed as we did not need to draw $7000.00+ a month.

We were however always told that this would upset the cash flows and it was best to leave things as they were.

3. Who was really monitoring our situation apart from us?

Cash Dam levels.

On *11 August 2008* we were very concerned about our cash dam level which had fallen below $8000.00 - a level that would not cover our next income payment due 15/8 or interest due to the Bank of Queensland on 22/8. We took numerous steps alerting STORM to this critical situation. Their failure to respond in a timely manner was very disappointing and disturbing. By 21 August, the day before the interest was due nothing had been done and our cash dam was then at $627.88

On 21 August we emailed, as follows, Bernardine Frawley, also a STORM Authorised Representative with whom we had met in the absence of our usual advisor:

"*As we are really concerned about the lack of available funds still evident in our MCMT account (available balance as at 21/8/08 is only $627.88) and as it also appears to us that we may have been left in a position of defaulting on interest due to Bank of Qld, we have tonight transferred $3,000.00 of our own funds to MCMT account. Hopefully this will cover the interest that will be due to Bank of Queensland on 22 August. However as we did not do this transfer until after 6.00pm we are not sure whether it will hit the Macquarie account in time.*

We have previously brought the situation of the low MCMT balance to STORM's attention at our meeting of 14/7 and again on11/8 when we were assured that the matter would be addressed as matter of priority. On Tuesday 19/8 we followed up our enquiry of 11/8, our main concern being the critical lack of funds to cover Bank of Qld interest due. Today we were advised that there would be an answer tomorrow (22/8/08) from STORM. However tomorrow,22nd of the month and the usual due date that interest to Bank of Qld is debited, seems far too late to be just talking about an action plan for the cash dam(MCMT).

We are sorry to say that we are feeling just a little less happy than we would like. We feel that in this instance a solution has been left to the11th hour and that it is we who seem *always to have to take the initiative to find out what is going to be done about the situation. You have assured us that STORM is there to look after us and so we don't feel that it is entirely appropriate that we should have to constantly follow up matters... especially one like this.*

Perhaps you do have the 'Ace's' in place already and we need not be feeling the way we do..if so it would be good to know sooner rather than later."

On 8 December 2008 we again took the initiative and advised STORM'S North Sydney office by email that *"before Christmas (our) funds will drop to about $5,000.00"*

We also advised STORM as to what we estimated we might have at the end of January 2009 However by this time it was clear to that the STORM organisation and its hardworking North Sydney staff were under enormous pressure and that the Financial Plan was falling apart as clearly there was either no strategy in place apart from using the Quarterly interest from the cashed down trusts. This interest would barely cover our interest repayments and income for January 2009.

We thought we had been promised that our situation would always be carefully monitored and for $96,630.00 upfront fees this was not an unreasonable expectation. But who was monitoring, apart from us, we would like to know!

4. Failure to alert us to dangerous gearing ratios.

We know Market behaviour and responses cannot be controlled. The response of advisors should be more reliable.

In late July 2008 after discussions with Bernardine Frawley we pledged a further $100K of our own savings to be linked as security against our Margin Loan. This was to reduce the LVR to a safer level.

This more or less happened because of our attention to our investment and our initiative.

We wanted cordial relations with our Advisors and the North Sydney Staff were dedicated and hard working but nonetheless it was upsetting and increasingly disconcerting that after having paid huge initial upfront fees not to mention the ongoing ones for the 'steps' that we always had to take initiative to 'kick off' appropriate action. We felt that we were doing all the 'watchdog' work!

On 10 July'08 we emailed STORM's North Sydney Office because of concerns re our Margin Loan.

We were very concerned about our gearing ratio which was showing we were *'in buffer'* with our gearing or LVR at 81.97% *versus* maximum gearing or LVR 79.79% and that a 3.33% further fall in the market would trigger a **"margin call"** which obviously we did not want.

We asked in our email what action we should be taking and and when we should be taking this action in order to prevent the possibility of a margin call as the market seemed to be going from bad to worse.

This pledged amount of $100K, along with our Challenger Investments and our secured individually owned shares were swallowed up in the repayment of our margin loan.

5 The Storm Financial Product

STORM as a company was sold to us as an industry leader, one of the largest independently owned financial planning firms in Australia with a professional and highly educated staff (most to Masters Degree level) whose philosophy and style of business would enhance our futures

Our Financial Plan did outline the risks involved in Geared Investing however it was expected that "positive outcome would outweigh the negative outcome of gearing in a falling market"

However the STORM investment model was not ever really described to us as a 'high risk high return model.

It was emphasised to us as being safe and conservative as it did not try to 'beat' the market returns, which were for safety sake, underestimated. The fact that the investment was in Top 200 ASX companies was further justification of its safety and near infallibility. Whilst it was pointed out that the stock market was beyond anyone's control, it was also stated that whatever the state of the market, the STORM model would not fail us as it was robust, stress tested, and had been proven to work in all market conditions – past, present and future.

The general approach was to 'gloss over' any doubts that we might appear to have. The possibility of the market falling to the point of a margin call was so unlikely as to never happen and this was justified by historical data to date, so we should not have real concerns about serious market falls ever becoming an eventuality. And STORM would always be there for us!

It was always emphasized that LVR'S would always be kept at safe and conservative levels. No more than 60% of our asset base was to be represented by borrowed funds.

6 .The Loan to Value Ratio - The LVR Deception

The main indicator of our debt/asset position was the gearing level or LVR which was available via Macquarie Margin Lending Summary.(MML)

During any advice session this was always a reference point. Whenever our advisor reviewed our position, the Macquarie Margin Lending LVR was always referred to and used as a key and current indicator of our true position and whether further investment should be undertaken.

Sadly it is only now and in hindsight that we have come to understand more exactly the degree of obfuscation that clouded our understanding and judgement in relation the all important LVR (Loan to Value Ratio) which was used when planning our 'Next Steps' i.e. additional investments. The LVR was so critical in determining whether the step was judicious.

When advising us our level of debt was always represented only by the LVR as per Macquarie Margin Lending's Summary.
There was no account taken of the $380,000.00 loan from the Bank of Queensland which was derived from the debt against the house - see* NOTE

This was not 'visible' as part of the debt/loan balance / LVR of our Margin Loan and was not ever referred to in discussion about our LVR.

Perhaps this was not Macquarie Banks's responsibility to separately flag the $380,000 debt from the Bank of Queensland which was drawn against equity in our house. But perhaps it should have been.

However we now realize that it certainly should have been STORM and our advisor's duty to take account of this additional borrowing by incorporating this into the account alongside Macquarie Margin Loan LVR so that we had a true and accurate picture of our total debt level when considering the next investment step. This was never done.

This omission and failure to consider the WHOLE debt position obviously gave a false and misleading reading of our actual investment situation.

So we are now of the view that every investment step we took was actually based on a false statement of our real debt position as only the Macquarie Margin Loan LVR was used as the debt indicator.

Consequently we were being put further and further into debt that we were not actually being made aware of, a debt that could not possibly be safely supported by the investments.

It now seems to us that from very outset we were advised to invest more and more based on the 'visible LVR' alone, when in fact our real debt level (i.e. the LVR as per our Macquarie Margin Lending Summaries + the $380,000.00 derived from home loan) should have signalled otherwise.

7 .A real example of the misleading LVR

In the period from October to December 2007 our "Current Gearing Level' was showing as: 61.54% (Current Loan Balance $1,686,153.00: Market value $2,739,735.00) which, according to STORM and our advisor, would represent a very acceptable situation - a safe gearing level, a no worry situation and an ideal time to further invest.

In fact we took another 'step' and invested a further $66,000.00 in December 2007.

BUT it seems to us that what really should have been not only visible, but also added to the loan balance to see the REAL LVR and true level of debt, was the additional $380,000.00 debt of borrowings against the house. This was after all borrowed along with the Macquarie Margin Loan with the sole purpose for investment into the Indexed Trusts.

Thus in the period from October to December 2007 the real LVR was in actual fact 75.06% i.e. Current Loan Balance: $1,686,153.00 + Home Loan of $380,000.00 = $2,066,153.00 *versus* Market Value $2,739,735.00. It was not the touted acceptable 61.54% - Current Loan of $1,686,153.00 *versus* Market Value $2,739,735.00.

Why then were we advised to invest when the gearing level, taking into account the real level of debt, was in fact at a very dangerous and unacceptable level of 75.06%

So, even when matters were under control and markets were still behaving in early 2007 and our 'visible' yet 'deceptive LVR' was showing on our MML Summary at a mere and supposedly safe and conservative 46.02%. the 'real and actual, but invisible and not taken account of' LVR i.e. the one taking into account the home loan debt (invested into the market) should have read as 64.4% i.e. Loan value of $950,818.00 + Home Loan of $380,000.00 = 1,330,818.00 *versus* Market value $2,066,077.00 and not as 46.02% i.e. Loan Balance of $950,818.00 *versus* Market Value of $2,066,077.00

***NOTE: -** *Home Loan Borrowings of $480,000.00 were used as follows:

1. $380,000.00 was used to invest and the balance was then used as:

2. $60,406.00 to STORM as upfront fees

3. $36,224.00 to our cash dam

8 The Double Jeopardy Mortgage

The loan against the house was not ever described to us in terms of a ‘double mortgage’

Our advisor recommended we use the equity in our house and borrow $480,000.00 (60% of the Bank of Queensland’s valuation) for further investment into the Challenger Funds. The rationale for this was to boost our investment and its potential earnings and so have the ongoing capacity to generate our income of $85,000.00 p.a.

Perhaps we missed something in our ‘Financial Plan’ in relation to the risk of liquidating 60 % of our property’s equity via the bank borrowing from the Bank of Queensland but the only reference to this risk in this strategy is on p 44: (Annexure D)

“Many gearing arrangements rely on you continuing to earn income to pay interest on the borrowed funds. If your income is not completely secure protect yourself by....making contingency plans such as holding sufficient reserves against such as event. Apply the same caution if you are thinking of using your home as security – borrow conservatively as default on the loan could mean loss of security for the loan. If you have used your home as security, this means you could lose your house”

But, according to STORM and our Advisor our income was going to be completely secure because STORM‘s product and strategy was proven – or was it?

We had no other source of reliable income apart from what our investments would generate. We were advised that the house borrowings were a significant part of the total borrowings and this would help expand our capital base and assure our income stream at the level of $85K p.a. So if borrowing against our house was a risk why put this strategy on offer and encourage/ persuade us that this was a good and safe course of action and that in fact we would not have really enough to live on if we did not do this.

Furthermore the assurances of our own advisor were totally contrary to the risk outlined. We had reservations using the house equity and expressed to our advisor our fear of the risk of losing our house and home. If the house was at risk we did not want to use the equity to boost our investment.

It is clear now that the real risks inherent in this particular strategy were not clearly and transparently explained to us.

In answer to our concerns about using the equity of our house, we were repeatedly and unequivocally assured by our advisor that we were not being put at risk of losing our house.
This would NEVER happen because if required the sale of the trust units would cover this debt, not the sale of the house.

We now know this was clearly totally incorrect and misleading. We can only assume that either our advisor had failed read our Financial Plan and/or had failed to understand the risks inherent in the STORM Product and our Financial Plan - that the borrowings against the house for investment purposes meant that in fact the house was 'double mortgaged' or did understand this risk but did not make this risk clear and unambiguous to us when discussing this option. But then this would have meant contradicting The Financial Plan being recommended!

This advice has now left us with the immanent and distressing prospect of having to sell our home to pay this debt.

9. Commissions

After our experience we are now firmly of the view that Financial advisors should be retained and not be paid any commission.

This is the only way to ensure the elimination of a conflict of interests and that advice can remain impartial and in truly in the best interests of the client.

We paid the fees as itemised

Source of fee	Amount $
Margin Loan	59,730.00
Home Loan	60,406.00 *
Superannuation	36,224.00*
TOTAL FEES	**156,359.00**

*** $96,630.00 of the above is the 'upfront fee' to Storm**.

Our initial attitude to fees was that as the upfront fees were for a lifetime of retained advice say for the next 20 years and as a one off, once and only fee was high but perhaps acceptable for advice "at call' (Our advisor had indicated to us that the fees were higher than average but this was a better than average company!)

This was not the case as every step involved a further fee. This was stated in our plan but we had interpreted ‘Future Investments’ (p56) differently.

We also rationalised the fees as a tax deduction as we recall our advisor agreeing that these fees were tax deductable. And, despite the usual disclaimer, we also thought we had understood as much from our Plan:

Page 80 of The Plan also states:” Sometimes, portions of fees you pay your advisor are also considered to be tax deductable against income earned in the year they are paid. This is the portion of fees considered to be for ongoing general advice in regard to your investment portfolio........”

This now appears to us to be just generic statement ’cut and pasted’ from somewhere and we now see there was no effort taken or research tdone to provide accurate advice relevant to the Plan that had (supposedly?) been specifically tailored for us. Not much chop for fees of $96K!

To date we have not been able to claim any STORM fees as tax deductions.

10. The Bank of Queensland and its Lending Practices

Prior to becoming a Storm Client we had no awareness of or any relationship with The Bank of Queensland and became a bank client after a tendering process for our business, arranged and implemented by Storm Financial.

At the time of applying and taking out the loan we did not ever speak to or personally meet with an actual representative of The Bank to discuss the purpose, nature or use of the loan or to advise or have confirmed the appropriateness of the loan to our circumstances.

To the best of our knowledge the only conversation we had with The Bank’s North Ward Branch in 2006 in relation to the home loan was when we called the Bank to advise that there was an error on the loan documents.

All paperwork for the loan was organised in the offices of Storm’s authorised representative. All liaisons in relation to this loan were between The Bank’s North Ward Branch and Storm; recommendation the bank’s offer and advice was provided to us by Storm Financial; We signed our the loan applications but they were completed by STORM Financials authorized representative.

Loan documents were posted to our home address for signature.

As the process of tendering to the banks for our loan that STORM organised made it appear otherwise, we did not initially think, that there was any special relationship with any bank in particular but being NSW residents we were not particularly aware of Bank of Queensland and thought it seemed unusual that a relatively small player in the banking world, from a branch in place we had never heard of and quite remote from us, came up with the best interest rate and the highest loan amount offer over ANZ, WBC and CBA. So whilst the tendering process for our home loan appeared to be transparent as far as what happened via Storm's North Sydney office, all processing went through STORM's Head Office in Townsville so we did begin to think that STORM must have had some relationship and influence with their local Bank of Queensland for it to win the tender for our loan that none of the 'BIG 3 Banks' could match.

Purpose of the Home Loan

Storm advised the North Ward Branch of the Bank of Queensland that we would be using bank borrowings to purchase as investment portfolio.

How did the Bank of Queensland actually assess our loan worthiness?

The bank's lending processes are of considerable concern because, whilst we ourselves have an impeccable borrowing and credit history, the flawed cash flows which were integral to the Financial Plan, our circumstances as retirees and our ages at this time should not have warranted a loan of the magnitude $480,000.00.

We address the matter of the Cash Flows below and in more detail in our Annexure C

On our loan application form our income is given as $85,000.00 from the income plan and $25,000 for my partner giving us a combined income of $110,000.00. Obviously, 85% of this total was to be derived from the proposed Financial Plan and the balance from my partner's casual earnings of $25,000 p.a. The latter was not income that could be relied upon and could not offer any security to loan of this size.

Questions for The Bank.

1 .Did the Bank of Queensland ever conduct its ***own independent*** ***analysis*** of Storm's data or did The Bank passively accept Storm's interpretation of the Challenger Indexed Funds Performance. Storms communication to the bank 27 June 2006 - **See Annexure A**

2. Did The Bank unquestioningly accept the communication of 27 June 2006 from STORM as evidence that we would be able to support this loan for the duration of 30 years and use this as the basis for approval.

3. Keeping in mind good lending practice, does The Bank, normally lend to a client on the basis of a graph and the interested 3rd party's own analysis/explanation of this?

4. ***Did the Bank ever request more detail of the Income Plan - such as the cash flows*** that were the basis of the so called Income Plan referred to in Storms Communication of 7 June 2006 - **See Annexure B**

5. If The Bank did not examine the Cash Flows then how did The Bank responsibly and reliably determine our ability to service not only the home loan, but simultaneously our Macquarie Margin Lending Loan and the provision for our annual income allowance of $85K from a graph of the Challenger Funds performance? How did it verify and confirm that STORM's data was based on reasonable assumptions, were workable, sustainable and safe for us.

Or Alternatively

If it did examine the STORM created cash flows it could not have found them to be sound or sustainable.

6. An examination of these cash flows should surely have been the appropriate course of action in order to comply with The Bank's own definition of responsible lending: "to reduce risk for the bank and to protect our customers from financial hardship is fundamental to success of our business" (quote from the Banks own website)

Our ability to service our home loan depended entirely and absolutely on the validity and the sustainability over the long term of cash flows, prepared for us by STORM.

STORM created cash flow projections for us from 2006 - 2022. As relatively unsophisticated investors we confess we always found them found them very difficult to understand. We ultimately trusted in our advisor and also Storms authorised representative explanation to us of these cash flows – which was that they were sustainable and workable going forward regardless of market conditions. Although we clearly recall that she too had some difficulty with the explanation.

As STORM was really acting as the Banks agent we believed that whatever was required and essential to make a responsible assessment of our ability to support the loan would be supplied to the bank and duly examined by the bank.

By the same token we also assumed that the Bank would require and request essential financial proof that the loan was supportable.

11. The 'Dodgy' STORM Cash flows - Refer to Annexure C also for detailed analysis

Recently, the impartial and trained financial minds of Senior Financial Advisors with whom we have now discussed our situation, have concluded to us in no uncertain terms that the mathematical logic and assumptions underlying these cash flows were dangerously flawed, that the cash flows themselves were therefore misleading and unsustainable and that whilst not immediately apparent to the untrained financial eye, reveal to the experienced professional financial advisor, that we were being put further and further into debt and that this home loan debt itself was being funded by nothing other than debt.

So did The Bank of Queensland do any independent and impartial due diligence to investigate further how the investments and the particular financial strategy embedded in the cash flows and Storm model would really support this home loan for the 30 year term?

We do not understand, how, if the banks financial experts had actually examined the Cash Flows, which comprised the Income plan they could not also have drawn similar inescapable and uncomfortable conclusions in relation to not only the mistaken underlying assumptions but the inability of the cash flow projections to be sustained and viable over time. – in our case until at least 2022 or even 2036!

The fact is, we now know, the STORM created cash flows were:

- **not sustainable**
- **not viable and**
- **did not have the ability to sustain the associated borrowings**.

Quality of loans and Nature of Relationship with STORM

If The Bank using its vast wealth of financial expertise and skill, had seen and examined them it depth it would surely also have been lead to question not just assumptions underlying the Storm Financial model and to have found them wanting and spurious in the extreme, but it would surely also have to seriously question and examine the nature of its own relationship with its agent and client, STORM Financial.

Also but more importantly, it would have to have been alerted to and seriously alarmed at the quality of the 300 or so loans it was writing for its STORM introduced clients.

If like us they arrived as, presumably, new and valued customers courtesy of STORM, The Bank should also have acted without prejudice, to protect its customer(s),from unnecessary risk, and if for no other reason than this have requested and analysed these cash flows.

12. The Banks and STORM

During our advisory sessions we gained the very clear impression that STORM was a much valued client of both the CBA, Macquarie Bank and also of the Bank of Queensland.

We understood that STORM, because of its relationship with Macquarie Bank had been allowed to negotiate higher than normal margin or more generous call thresholds of 80% + 5% buffer.

On the brink of disaster in December we were told by our Advisor that Emmanual Cassimatis had promised that money to assist us back into the investment market would be available as an interest free loan. We understood that this would be possible because of there was special relationship between STORM and the Commonwealth Bank.

We believe that this information was passed to us in good faith and in our naivety and in keeping with our attitude of trying to keep faith in STORM and our advisor suggested that it would be more comforting to actually see the promised amount and even suggested a process as to how these funds to give us hand up into the market again could be allocated to us!

SEE ANNEXURE C – BELOW PP 22 -29

ANNEXURE C

COMMENTS AND OBSERVATIONS

on

THE STORM FINANCIAL STATEMENT OF ADVICE

(The Business of Making Money)

&

THE BANK OF QUEENSLAND LOAN APPLICATION DOCUMENTATION

We have spoken with a number of people, including financial services industry professionals, about the situation in which we now find ourselves. As a result, we have compiled the following comments and observations about the above two documents which are central to the Financial Plan recommended to us by Storm Financial.

Annexure D

THE STORM STATEMENT OF ADVICE

In this section, we have extracted various statements from within the Storm Statement of Advice and then provided a brief comment on their validity.

Page 16

The SOA states: "Your Cash Reserves do form a part of your investment and so should not generally be accessed without consulting your adviser. Usually, the dividend streams are reinvested in the share component of your investment. This means that these reserves are being stored as extra units so they earn a higher rate of return until they are needed……and because they are debt free, they can be accessed very quickly and so form a part of your liquid assets."

As summarised later in this document, the dividends from our Storm designed Plan were significantly less than the Plan's outgoings, hence dividend reinvestment could not have been sustained.

Also, the SOA states, on many occasions, that the investments are for the long term and should remain invested for at least 5 to 7 years. So, in hindsight, how can they assert that the extra units form a part of our liquid assets?

Page 17

We now realise that the SOA contains a very biased story against property investing. It includes statements like "We believe that the returns flowing from property in the past are unlikely to continue because of long-term structural shifts in demography." This is a very strong position for Storm to adopt.

Page 19 – The Family Home

In the section "Review of Sector Asset Allocation Pre and Post Plan", the SOA compares the our total asset allocation INCLUDING the family home with the asset allocation of typical balanced funds which EXCLUDE the family home. The SOA then makes the assertion that we should, over time, change our asset allocation towards the balanced fund by adding equities through gearing.

We have now discovered that use of the family home within the review of a clients' asset allocation is **not** normal industry practice and the conclusion drawn is, therefore, invalid.

Page 22 - Insurance

The SOA states: "Following investigation into your existing insurance arrangements, we advise that you currently do not have sufficient insurance in place to guard you against the consequences of unexpected events. At this time, we have not included estimates of the costs associated with additional insurance….insurance is likely to be a large or impossible outlay to consider."

Our adviser at the time has effectively advised against insurance. Yet, on page 32, the SOA states:

"We have suggested to you that additional insurance is prudent to cover the new level of debt recommended in the plan. This adds to the other safety parameters that have been included in the overall recommendation."

Firstly, this conflicts with the statement on page 22. Secondly, having "suggested we take additional cover", the adviser took no further action.

Page 24 – **Cash Flows**

The SOA states: "We have prepared a cash flow that tracks estimated revenues and expenses…..This analysis assures us that the plan is viable and that the associated borrowings are manageable."

Clearly, we can now see that this statement is incorrect as discussed in the analysis below.

Page 32

The SOA states: "The estimated level of cash reserves is documented for each of the 17 financial years detailed in the Cash Flow. Recall that your Cash Reserves Dam is the amount that remains after all the revenue of the Plan is received and all of the expenses associated with the portfolio have been paid."

Earlier in the SOA, the adviser had suggested that dividends should usually be reinvested.

In the last paragraph on page 32, the SOA states: "See the graphical representation of the rising value of these Cash Reserves over the medium term on page 2 of the Cash flow." This Cash flow analysis is included in Appendix B.

The graph clearly shows Cash Reserve Levels starting at around $190,000 then falling to around $65,000 after a year and a half. The Cash Reserve Levels then turn sharply and show a continued rise over the full period of the projection to 2022.

The Cash Reserves shown in the graph do not agree at all with the Cash Reserves shown in the table that follows two pages later. We now realise that the Cash Reserve Levels in the graph are in fact the Total Reserves in the table. These Total Reserves are made up of the growing overdraft offset by the unrealised Accumulated Investment Growth".

In fact, the cash flow table shows a VASTLY different story to the Cash Reserve Levels graph as summarised in the table below; that is, the level of cash reserves actually declines into a growing overdraft for the life of the Plan:

Date	Cash Reserves
	$
July 2006	187,205
July 2007	72,042
July 2008	- 29,047
July 20091	- 130,372
July 2010	-238,010
Through to	
July 2022	- 2,425,300

This outcome is not surprising when you look at the income and expenditure figures as shown below for July 2007, July 2008 and July 2009:

	2006/2007	2007/2008	2008/2009
	$	$	$
Opening balance July 2006:	187,205	72,042	- 29,047
Plus:			
Annual interest	4,867	1,873	- 3,108
Annual distributions	62,860	62,860	67,103
Tax credits	0	19,578	20,080
Sub-total	254,932	156,353	55,028
Less:			
Yearly living expenditure	- 85,000	- 85,000	- 85,000
Margin loan repayments (interest)	- 60,450	- 62,000	- 62,000
Bank repayments (LOC interest)	- 37,440	- 38,400	-38,400

Net cash reserves at year end	72,042	-29,047	- 130,372

As each year progresses, the situation becomes increasingly worse.

Very simply, outgoings continue to far exceed the income that the portfolio generates.

The cash flow projection brings to account a line titled "Accumulated Investment Growth" and another titled "Total Reserves" as shown:

Accumulated Investment Growth	0	107,419	222,088
Cash reserves	72,042	- 29,047	- 130,372
Total Reserves	72,042	78,372	91,716

The way it is presented gave us the impression that we would be in a positive situation each year. At no time, were we advised that we would have to draw down against our loan and/or capital to fund the shortfall between outgoings and income.

By 2022, the Accumulated Investment Growth is shown as $2,647,915 which is the theoretical increase in the value of our investments. If the investments were to be redeemed to offset the rising overdraft, then it is likely that capital gains tax would have been payable. There is no mention of this possibility in the plan.

By 2022, the Cash Reserves are shown as being - $2,425,300; that is, we would have an accumulated debt of $2,425,300 in addition to our original bank loan of $480,000 and margin loan of $775,000 – a total debt of $3,680,300.

One would have to question whether we would be able to sustain this end level of debt at the ages of 80 and 78 respectively, let alone be able to cope with it along the way. In fact, it was this rising level of debt by the second year that led us to draw on a small amount of other cash reserves to pay down some of the debt.

The net gain over the 17 years is just $222,614, although, theoretically, along the way, we would have sustained a lifestyle of $85,000 per year.

Page 43

The SOA states: "Borrowings are never to be used for consumption purposes." However, the only way for us to meet our $85,000 per year lifestyle expenditure was to draw down further against our capital and/or our loan facilities.

Page 44

The SOA states: "gearing should not exceed 60% of your asset base", however, the cash flow report shows initial gearing is 79%.

Throughout, the SOA refers to the "purchasing of Business Assets" and "your Share Investment Business". This really gave us the feeling that we would be in full control and that we were effectively starting and running a "business" that followed a proven model.

Page 63

The SOA states: "We manage the volatility of your investment by ensuring that you have adequate Cash Reserves to use for your Plan when the income and growth from Shares is low. When the returns from your Share investment rise, we will replenish the Cash Reserves: in this way they act as a "dam" to ensure that the variability of returns becomes insignificant to the operation of your Plan. It is very important that these Cash Reserves be maintained for the purpose described above – they are not provided to finance private spending, and should not be used for any purpose without prior consultation with us. Please ensure you recognise that these funds must be regularly placed into the Cash Reserves dam."

As outlined earlier, at no stage in the estimated cash flow projections does the Cash Reserve increase. In fact, the table clearly shows the "Cash Reserves" to be in the negative and they are even printed in red. Clearly, we now realise that after just two years, we would have been into an overdraft. This overdraft figure is "offset on paper" by the supposed increase in the value of the investment portfolio; that is, unrealised capital gains.

Page 64

The SOA states: "should you implement these Recommendations in full your overall debt ratio would be 49%, which is made up of liabilities of 60% of the value of your home and other property assets and 48.7% of the value of your Share-based assets."

Surely, this would make our overall combined level of liabilities as being much greater than 48.7% and less than 60%?

THE BANK OF QUEENSLAND LOAN APPLICATION DOCUMENTATION

The loan application makes a number of statements which are completely wrong. We have two documents and our observations on each of these are as follows:

Annexure B

Original letter of application from Storm Financial, letter dated 7th June 2006

The letter includes a client rating which is quoted as "AA". How was this derived?

On page 2, the letter states: "The clients can provide a statutory declaration for (annual income of) $110,000 which will include income drawn from their investment plan."

As the analysis of the SOA above shows, for example, in 2008/2009 that interest expenditure on the two loans would have been $100,400 whilst net income would have been $87,075 including the value of franking credits, resulting in a net outflow of - $13,325. Hence, to fund our lifestyle, we would have been drawing down from our loan facilities at the rate of $85,000 per year for lifestyle expenses plus $13,325 to fund the additional interest costs.

Clearly, we now see that the $85,000 was not "income generated by investments in the plan" as stated in the letter and also shown in the Confidential Financial Profile.

The Financial Profile also states that "Loan repayments will be met (implying fully met) by using income from the plan." How can this be when the plan income, including the grossing up effect of franking credits is less than the interest costs of the loan?

This letter makes no mention of the fact that the we would also be pursuing a margin loan as part of our "investment plan".

Annexure A

Fax to Bank of Queensland from Storm Financial, dated 27th June 2006

This fax is designed to provide further information to the Bank of Queensland to support the application.

In it the fax states: “In total, Mr .... and Ms .... will have invested $1.5 million into the Challenger Australian Share Market Indexed Trust

Firstly, it does not clearly show how we were to have funded this portfolio although there is a single reference to “margin loan repayments” on page 2; and

Secondly, it is inconsistent with Storm Financial’s recommendations on page 53 of the SOA which shows:

- $105,000 Storm Australian Technology Indexed Trust
- $1,015,000 Storm Australian Industrials Indexed Trust
- $380,000 Storm Australian Resources Indexed Trust

There is no reference to the Challenger Fund.

The fax also states: “The investment plan incorporates an annual living expenditure of $85,000 to be paid to the clients, and the plan also services all bank and margin loan repayments in addition to the income listed above.”

As the analysis above has demonstrated, the income from the investment plan does not even cover interest repayments on the bank and margin loans, let alone fund our annual living expenditure.