Submission to the Parliamentary Joint Committee on Corporations and Financial Services

- *Inquiry into issues associated with recent financial product and services provider collapses such as Storm Financial, Opes Prime and other similar collapses.*

Appendices:

- *SICAG membership survey*
- *Code of Banking Practice*

Submitted by:

STORM INVESTORS CONSUMER ACTION GROUP INC. (SICAG)

SIGNED:

Mark Weir (Co-chairman) -I- Noel O'Brien (Co-chairman)

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SICAG Inc. (Storm Investors Consumer Action Group Inc) profile

December 8, 2008, is the date on which Storm Investors had visited upon their lives, indirectly, the consequences of the global economic meltdown.

It was on that day that some Storm investors received a phone call from Colonial Geared Investments advising them that their portfolios had been sold and the Storm index funds were shut down as a result. A large number of clients were dealt a further devastating blow when they were informed that at the point at which their portfolios were liquidated, a shortfall in their LVR (loan-to-valuation ratio) resulted which meant that not only were their portfolios worthless, they were left with a substantial debt in negative equity. In many cases, this resulted in investors being forced to sell their family homes, despite repeated assurances from their advisers that their homes would never be at risk.

Much of what is described in the events in connection with CGI is duplicated in the experience of Storm clients with margin loans through Macquarie Margin Lending and other margin lenders. Margin calls were not made as prescribed by the model resulting in clients' portfolios sustaining heavy losses. Although fewer clients were allowed to enter negative equity, notwithstanding, most escaped with very little equity

intact and in this regard were not materially better off than the CGI clients.

Accordingly through their actions, Macquarie Margin Lending deserves to be held accountable to the same extent as CGI for their involvement in this financial catastrophe.

These events marked the beginning of what has been described as the worst collapse of its kind in Australian history. Total losses have been estimated at $3 billion.

While the financial toll has been widely acknowledged, the human toll is impossible to accurately measure.

SICAG is directly aware that hundreds of its members have suffered psychologically from the collapse of Storm Financial. Hundreds of our members have sought treatment for depression, anxiety and related ailments and have been prescribed anti-depressant medication. Sadly, a significant number of SICAG members have talked openly of committing suicide. In one case, a couple who had lost their considerable life savings contemplated a scenario where they would disappear while on a snorkelling trip, leaving their only remaining asset – a life insurance policy – to their children.

In another case, a young man wrestled a rifle from his father and talked him out of shooting himself.

While there is reasonable hope at the time of writing of some form of mediation and possible resolution with the banks, the human damage wrought by the Storm collapse can never be rectified.

The legacy of the manner in which the banks have treated Storm investors in the lead-up to and in the wake of the collapse of Storm is a

lasting suspicion and distrust of the banking system and the investment advisory industry.

SICAG's website has been an invaluable source of information for its members. It has also acted as a safety net and a sanctuary for people seeking assistance. The site carries links to support sites such as Lifeline, Beyond Blue, Salvation Army and Centrelink. There is also information about mental health seminars and crisis recovery programs facilitated by SICAG. The site is linked to Slater & Gordon's informative website, KordaMentha (receivers) and other useful sites.

What followed the events of December 8, 2008, was a period of utter bewilderment. This was exacerbated by developments that were playing out between the Australian Securities and Investments Commission (ASIC) and senior management of Storm Financial. These developments surrounded an Enforceable Undertaking, effectively a demand by ASIC that Storm advisers not engage with clients. This was designed to force clients to seek out a financial adviser other than Storm and was based on a suspicion by ASIC that Storm was not providing appropriate advice at that time. So, in this hour of critical need, when Storm clients were trying to get information as to what their position was, their advisers were effectively silenced. The consequences of this action by ASIC were disastrous and served to compound the emotional distress and confusion being suffered at that time by Storm clients. The Storm clients were simply hung out to dry, deserted and completely stunned. Quite

clearly the damage caused in terms of the emotional terror experienced by these folks persists to this day.

This action by ASIC, in retrospect, can only be interpreted as one of indecent haste aimed at achieving a speedy resolution – or at least to be seen to be doing so – to a perceived injustice.

The lack of information as a result of the effective silencing of Storm advisers played a significant role in bringing SICAG into being. It served as the catalyst that caused clients to grasp at the opportunity to fill the void left by the absence of their financial adviser.

In the period prior to Christmas 2008, much of the media publicity surrounding the Storm issue dwelt on the sensational aspects of the collapse of Storm Financial and the activities of its founders, Emmanuel and Julie Cassimatis, leading up to and following the closure of the business.

The perception in the media was that the clients of Storm Financial – the unwitting victims of this debacle that was unfolding – were greedy high-flying gamblers. Little attention was given to the human tragedy that existed behind the headlines and the staggering numbers that were emerging.

It was in this scenario (mid-December) that Mark Weir and Noel O'Brien, two Storm investors and long-time friends, happened to engage in conversation and concluded that something must be done to bring

Storm clients together so that information could be shared and, more importantly, to provide a support network for distressed and confused investors.

Unfortunately, Christmas intervened and took precedence over these discussions temporarily. Shortly after Christmas, Storm investors, Mike and Maureen Simons, who reside in the same locality as Mark, made an effort to seek him out and eventually knocked on his door. Mike and Maureen had been to a post-Christmas function and had met a former Westpac senior executive called John McLennan. John had taken a particular interest in their predicament and concluded that the Storm events showed similarities to a campaign he had been involved in some years earlier where banks had acted improperly to the detriment of their customers. It was these events that renewed Noel and Mark's determination to unite as many ex-Storm clients as possible. Noel began networking by telephone with known clients and Mark did the same by email. The network grew very quickly and it was resolved that a meeting should be arranged urgently.

Upon John's return from a Christmas break, Mike and Maureen introduced him to Mark Weir. John retold the story of his involvement with a campaign to seek justice for victims of a foreign currency loans scheme that led to millions of dollars in losses for investors who took the banks' disastrous advice to borrow Swiss francs.

It became immediately apparent that John's experience as a former bank executive and, later, bank consumer advocate would be invaluable to Storm clients. John volunteered to provide assistance in whatever way he could and urged the formation of an action group.

Following this, a meeting was scheduled to be held on the Redcliffe Peninsula on Tuesday, January 20, 2009. In an effort to lock in an agenda for the meeting, the following volunteers made themselves available for a planning meeting on Saturday, January 17, 2009 – Mark Weir, Noel O'Brien, Graham Anderson and Mike Fishpool, all ex-Storm clients. Also in attendance were John McLennan and Max Tomlinson. Max had been recommended and subsequently engaged as a media adviser to the fledgling action group.

Although this meeting could not be deemed an official meeting, those present were the nucleus of what was to later be appointed as the committee.

An agenda for the January 20 meeting was prepared and a draft mission statement proposed, to be ratified at a subsequent public meeting.

SICAG MISSION STATEMENT

- ✓ **To restore members' lost assets and to protect existing assets;**

- ✓ **To agitate for a parliamentary inquiry into the plight of our members and the banking industry in general; and**

- ✓ **To provide a communication and network structure to assist members through their personal, financial and in some cases, psychological issues.**

The inaugural meeting was held at the Golden Ox Restaurant and Function Centre in Margate. Organisers were overwhelmed when over 400 people attended, straining the capacity of the function room. It was standing room only.

The meeting was jointly chaired by Mark and Noel; guest speakers were John McLennan, Damian Scattini (Slater & Gordon Lawyers), Senator John Williams and Trevor Clark (ASIC representative).

The proposed committee members were confirmed – Noel O'Brien and Mark Weir (Co-chairmen), Graham Anderson (Secretary/ Treasurer), Peter Wallace and Mike Fishpool (committee members). Some time after this meeting, Luke Vogel was appointed to the committee in recognition of his involvement in getting the SICAG website active.

The proposed mission statement was unanimously endorsed, along with a suggestion that membership of SICAG, which was soon after incorporated, would be by way of a subscription set at $50 per person. Funding of SICAG has also been augmented by voluntary donations.

The Margate meeting endorsed as a matter of urgency that information meetings be held in Townsville, Rockhampton, Mackay and Cairns.

Accordingly, a meeting was held in Townsville on Wednesday January 28, 2009, attended by an estimated 700 people. Meetings then followed at Rockhampton on Tuesday, February 24, attended by around 170 people, Mackay on Wednesday, February 25, with a similar figure in attendance and Cairns on Thursday, February 26, with approximately 300 attending.

While on the road trip, SICAG representatives took the opportunity to brief media, politicians and community leaders about the organisation's mission statement, its aims and the dire financial straits many former Storm investors were facing.

Almost from day one of its campaign for justice, SICAG was agitating for a Parliamentary Inquiry into the Storm Financial/CBA/Bank of Queensland/Macquarie debacle. The original momentum for an inquiry was driven by Senators John Williams and Ian Macdonald. Then just 36 days out from SICAG's inaugural meeting, the Federal Government took the initiative in announcing that the Parliamentary Joint Committee of Inquiry into Financial Products and Services would look into the collapse of Storm Financial and other related matters.

When this was announced, SICAG was disturbed to note that the Terms of Reference made no specific mention of the banks' involvement in the collapse of Storm and accordingly registered a protest. The Terms of Reference were subsequently amended to include the role of the banks in the obliteration of Storm Financial.

SICAG can reasonably claim to have been a credible force in promoting and working toward a satisfactory outcome for its members as enunciated in the group's mission statement.

We are proud of what has been achieved in a relatively short period of time and with limited resources.

One outstanding feature of our achievement surrounds our engagement with all segments of the media and we believe that this has contributed significantly to our success in winning over public support for our cause.

SICAG has, we believe, been of immeasurable assistance to members in its provision of advice and guidance, within the capacity of committee members, and to the emotional well-being of our members generally. SICAG doubts if it will ever be determined just how much of a lifesaver, both literally and metaphorically, our organization has proven to be when considered in the light of the absolute trauma with which members were confronted.

SICAG's gains would not have been possible without the thousands of voluntary man-hours willingly provided by the committee, the advice of various consultants (particularly John McLennan), the guiding hand of Damian Scattini of Slater & Gordon, the media, politicians of all persuasions, Carey Ramm of AEC Group, Allan Tompkins and Steve Reynolds (SICAG's NQ co-ordinators), members and supporters who provided meeting venues, accommodation and hospitality during SICAG's regional tour, and the hundreds of former Storm investors and

supporters who have provided welcome inspiration. Wives and partners of SICAG officials and supporters also deserve public recognition for their undying support.

SICAG links to Storm Financial/Emmanuel Cassimatis

In the time leading up to the formation of SICAG, Emmanuel Cassimatis made contact with SICAG officials on a number of occasions offering assistance, advice and support. It was decided at an early date that SICAG should divorce itself from Mr and Mrs Cassimatis and Storm Financial pending the outcome of the various complicated legal proceedings, company winding-up formalities and the investigation announced by the Australian Securities and Investments Commission (ASIC). It was very important to the committee that SICAG focus its attention on its core mission statement aims, namely to represent the interests of the VICTIMS of the collapse of Storm Financial and not those of Mr and Mrs Cassimatis. At that time, it was strongly felt the two groups had to remain mutually exclusive. Mr Cassimatis was informed of this policy decision prior to SICAG's Townsville public meeting and as a result concentrated his efforts in other areas, including engaging a public relations firm to present his version of events leading up to the winding up of Storm Financial.

SICAG membership profile

Current membership of SICAG at the time of writing is 1536 and growing. A number of non-Storm clients have been in contact with SICAG with information relating to their own grievances against banks and the financial services industry. Consideration was given by the committee to broaden the scope of SICAG's activities to include non-Storm clients; however, it was decided to maintain the organisation's focus on its members. This decision was based mainly on the group's limited resources.

SICAG's membership is made up of people from all walks of life – ranging from sophisticated, well-informed traders to relatively naive mum-and-dad investors who put complete faith in their advisers to look after their interests.

The majority of the clients of Storm Financial could best be described as hard-working, resourceful human beings who were attempting to secure for themselves and their families an independent and comfortable retirement.

As a result of the Storm Financial experience and the conduct of the banks, it can be safely said that all SICAG members now harbour a lasting distrust of the banking system, the investment advisory and financial planning industries and strongly support consumer protection reforms.

Members have also lost faith in the ability of the current regulatory regime to prevent a repeat of the Storm Financial scenario without significant changes.

Membership survey

A survey of 419 SICAG members was conducted in April 2009. Raw data was collated by AEC Group into a database ***(Appendix 1)*.**

Below is a snapshot of the SICAG membership from the survey:

- **Demographics:**
    - 32 % of members are based in the Greater Townsville statistical district;
    - 30.3 % of members reside in Redcliffe/Brisbane area;
    - 25% of members are drawn from the regional centres of Cairns, Mackay and Rockhampton.
- **Age Brackets:**

  The bulk of Storm clients would best be described as "Baby Boomers". Most members are either retired or approaching retirement.

  A breakdown of age sectors is shown below:

- 30-49 years (22.7%);
- 50-59 years (29.5%);
- 60-69 years (38.3 %);
- Over 70 years (8%).

- **Risk Tolerance:**
  - Only 4.8% of respondents claim to have been advised that there was a risk of losing the family home should markets drop;
  - Almost half of those in survey now face having to sell their homes to clear debts;
  - 67.8% of respondents will not have sufficient funds to be able to purchase another home after the sale of their existing homes.
  - 98.3 % of investors say they trusted Storm Financial to manage their portfolio and keep them informed.

- **Future Prospects:**
  - 25% of members will need to rely on Centrelink benefits;
  - 61% say they will be forced to find employment in a shrinking job market. Many of these members are aged over 60 and therefore face limited opportunities.

- **Bank Loans:**
    - 80% of surveyed members' loans were arranged by Storm Financial;
    - 83% said they had no contact with any bank officer before or during the loan application process;
    - Since the collapse of Storm, only 24% of respondent members have been contacted by their bank;
    - 80% of the loans to members were provided by CBA/Colonial;
    - Only 4.5% of members recall their Storm Financial adviser suggest they seek independent legal advice before signing loan documents

The Storm Financial experience

The major attraction of the Storm investment model was that it was based on investing in index funds that passively tracked Australian stock market indices, notably the ASX 200 Index and the All Ordinaries Index, with built-in safety nets based on over 100 years of market history. The symbiotic relationship between Storm and its lending partners, particularly the CBA/CGI and the Bank of Queensland, gave investors confidence that the strategy had the support and the backing of the

banks. In addition and as further proof of the support and backing of Storm's lenders, Storm was able to negotiate more generous LVR (loan-to-valuation) ratios with CGI, a division of the CBA, than those available to clients of Storm's competitors.

Storm enjoyed a unique and intimate relationship with its lending partners, in particular the Aitkenvale branch of the Commonwealth Bank of Australia and the North Ward branch of the Bank of Queensland where most of the loans were written.

Storm clients were under the impression they had invested in a fail-safe index-based investment environment that had the direct support of the banks and had adequate built-in pressure release valves to withstand the cyclical nature of the market. They were told on a number of occasions by Storm founders and advisers the world would have to end for them to lose their investments. They were also repeatedly told their homes were not at risk.

It is now known that Storm was one of the only – if not the only – company promoting margin lending to investors with limited external income-earning capacity and therefore limited ability to repay debts, e.g. retirees. This sector represents about 70% of SICAG's members. With the benefit of hindsight, the one-size-fits-all Storm model was not appropriate for these investors.

The banks' complicit support of this investment strategy appears to be in direct contravention of Part D of the Australian Bankers Association **Code of Banking Practice** viz. Page 18, Section 25.1 which says:

> *<u>Provision of credit</u>*
> *Before we offer or give you a credit facility (or increase an existing credit facility), we will exercise the care and skill of a diligent and prudent banker in selecting and applying our credit assessment methods and in forming our opinion about your ability to repay it.*

Storm's founders fostered a "family" sentiment among the company's 14,000 clients, reinforced by three lavish overseas trips to Canada, Europe and South Africa. The trips were funded by Storm clients with significant financial sponsorship from Storm and at least two of its lending partners, Colonial Geared Investments and Challenger Investments Management Limited.

Following the trips, clients were urged by Storm founders Emmanuel and Julie Cassimatis to write to Colonial to thank them for their financial support. This was clear evidence of the very close association that existed between Storm and its lenders.

Following Storm's aggressive expansion program which began in 2003, wherein a number of independent investment advisory companies were acquired prior to the aborted attempt to float the company, the Storm investment model effectively became a "one-size-fits-all" arrangement with all loan applications and back-end administration being handled compulsorily in the Townsville Head Office.

This "cookie cutter" philosophy effectively marginalised and emasculated local advisers who found themselves powerless to tailor investment strategies to suit the individual needs of their clients by taking into account their personal circumstances.

In many cases, paperwork was completed on the client's behalf, often without the client ever having sighted the documents.

Storm effectively became a one-stop shop, aided and abetted by its compliant preferred lending partners in Aitkenvale (CBA) and North Ward (Bank of Queensland). During this period of time, both the Aitkenvale branch of the CBA and the North Ward branch of the Bank of Queensland were by far the nation's leading branches with loan books other branches could only dream of.

Representatives of both the CBA and the BoQ were regular visitors to the Storm office in Sturt Street, Townsville. It was an extremely close and symbiotic mutually rewarding relationship.

Loan applications were routinely massaged to ensure the loans met the banks' approval criteria. SICAG members who have successfully retrieved their loan documents – many of which contain blacked-out sections – have been shocked and alarmed to find serious errors relating to the stated annual income and in many cases personal data.

SICAG understands that ASIC investigators and Slater & Gordon lawyers have sighted hundreds of these creatively doctored documents, indicating that the practice was systemic.

It should be pointed out in this context that dozens of SICAG members, after formally applying for the return of their loan documents from Colonial, received documents relating to complete strangers. This is a clear and blatant breach of privacy that upset SICAG members at a time when they were at their most vulnerable.

Storm charged high up-front fees (7.5%) compared with its competitors and lower on-going fees. There were no on-going service or adviser fees or plan preparation fees. The only other fee was the MER (Management Expense Ratio) which was charged by the fund – 1.14% for balances under $500k and 0.79% for balances over $500k. Also, any buy/sell costs (a transactional fee imposed by fund managers when funds are bought or sold) were always paid by Storm on behalf of the client. The idea was that by paying an extra 3% or so up front, much lower on-going fees could be levied.

Storm founders Emmanuel and Julie Cassimatis and Storm advisers encouraged investors to free up “dormant” capital (family homes, investment properties, superannuation and other assets) and talked up “good debt” versus “bad debt”. Investors were urged to top up their cash with margin loans so as to “supercharge” the amount of money available to be invested. History has clearly shown that this relatively sophisticated

strategy was not appropriate in all cases, particularly for retired and/or elderly clients who had no other independent source of income.

Only 4.8% of clients (see SICAG survey – attachment) were aware that this strategy effectively placed them in double jeopardy and that their family homes may be at risk.

Investors were told the Storm investment model was sorely tested during the 1997 South-East Asian currency crisis, the so-called "tech wreck" in 2000, the 9/11 terrorist attack on the Twin Towers in New York in 2001 and the invasion of Iraq in 2003. The fact that it reportedly survived those testing times gave investors confidence in the Storm model and emboldened the strategy's promoters. **NOTE: SICAG is now aware this claim by Storm may not be correct – some Storm clients were reportedly bailed out of trouble during the tech wreck by Storm founders.**

It is fair to say that many Storm Investors felt secure in the knowledge that the Storm badged funds in which they were investing were in fact developed, owned and managed by Colonial First State, a funds manager with a proven record of performance over many years.

VAS computer valuation system

Storm clients were routinely targeted by the Commonwealth Bank's computerised valuation system called VAS. The system was designed to trawl through the bank's client database and remotely value upwards assets such as the family home and investment properties. This information was then shared with Storm who used the information to encourage clients to borrow more money to invest with Storm. It is not known if this mutually beneficial practice involved commission payments.

The systems fail

A large number of submissions tendered to the Parliamentary Joint Committee confirm the abject chaos and lack of communication that existed in both the Storm Head Office and inside CGI. The paucity of information was exacerbated by the failure of the CGI online reporting system to cope with the demands placed on it. This confusion was exacerbated by inadequate staffing at both the CGI and Storm offices at this time.

SICAG further believes the CGI on-line reporting system contained a serious flaw embedded within its algorithms, resulting in delayed delivery of information and inaccurate clients' portfolio positions.

Just who is responsible?

SICAG has had extensive discussions with Mr Paul Johnston who was head of Colonial Margin Lending from its inception in early 1996 until his departure from the company in 2003. Mr Johnston, who is known as the father of margin lending in Australia, has advised SICAG he was responsible for growing the margin lending book from less than $1 million at the date of his appointment to $1.9 billion of loans. He was also responsible for the management of $918 million of lending through CBA subsidiary, Commsec.

Mr Johnston was responsible for producing, developing and implementing the rules, procedures and protocols for the margin lending product, in addition to sales and distribution control.

Mr Johnston makes the following points:

- *An agreement entered into between CGI and Emmanuel Cassimatis in May 2007 (see Ron Jelich's submission No.54 to this inquiry for a copy of this agreement). The agreement provided for an upward movement in loan-valuation ratios exclusively for Storm clients. The agreement allowed for an increase in the buffer from 70% to 80% and from 80% to 90% for a margin call. There appears to be no evidence of any formal advice to advisers or clients of this variance. The agreement was in fact not adhered to, as it talks about moving the buffer from 70% to 80% and the margin call from 80% to 90% for certain Storm funds, whereas in fact the real ratios sat*

somewhere in the low 80's for buffer and low to mid 90's for margin call.

- *From a risk management viewpoint, it seems an unnecessary risk to take, given the volume of business generated . . . also if this was something I would do it would have happened back in 1996 so as to give me a superior competitive edge in the market.*

- *The loan agreement is and always has been between the client and the borrower, not the agent – in this case, Storm.*

- *After consultation with a former IT colleague at the bank, I believe a margin loan facility could not go past 100%. If it did, it would be the bank's problem, not the borrower's.*

- *The lending parameters were set at 66%, giving the bank, the adviser and the client a level of comfort from a risk management standpoint. To take the buffer to the low 80s and margin call to low to mid 90s is very risky.*

- *At all times during my tenure as head of margin lending, margin call notices were sent automatically to clients, in writing, with advisers copied in for reference. If a margin call was not rectified within five days I felt it was my right and duty to sell the client up (unless evidence was supplied that positive action was being taken to meet the margin call) to protect the client and the bank's position. I believe I (on behalf of the bank) was liable for any shortfall if action*

wasn't taken at the end of five days or 24 hours if direct shares were involved. The five-day window was a generous timeframe compared to other margin lenders at the time.

- *The margin call was always automatically generated by a computer system used by the bank called original MLS, now known as 'EMPIRE'. A margin call notice could only be stopped through manual intervention.*

- *I was instrumental in the writing of clause 4.2 of the terms and conditions which talks about 'you' receiving a margin call. My knowledge and practical application of that clause is that the bank contact the client in writing, then the client (in consultation with the adviser) rectifies the position. Again, I should stress that if the margin call wasn't fixed in the five-day period, I immediately sold the client down to protect BOTH parties (unless evidence was supplied that positive action was being taken to get the call fixed).*

NOTE: Mr Johnston, who is unwell, has endorsed these comments in writing. He has indicated he is willing to give evidence to the Joint Parliamentary Inquiry in person if asked to do so.

Panic, confusion, staff shortages

This atmosphere of panic, confusion and lack of accurate information from either Storm or Storm's lending partners made it impossible for clients to make informed decisions about their financial positions.

To compound the situation even further, clients were never notified of margin calls and thus were never given an opportunity to keep their portfolio liquid. At the height of the confusion and in the midst of a market that was plunging daily, the CBA made a decision to sell down the Storm index funds, leaving many clients with negative equity and facing the prospect of selling their family homes to meet their loan commitments.

SICAG believes the CBA made its decision with undue haste amid the panic that prevailed at that time without any regard for the clients. The bank justified its actions by sheeting the responsibility for keeping clients informed to Storm. In turn, Storm publicly blamed the bank. While the blame game was being played out in the media, Storm investors were left to pick up the pieces of their shattered lives.

It needs to be noted that a prima-facie determination in the Federal Court on 24 December 2008 indicated that the CBA might have a case to answer in regard to deceptive and misleading conduct by circulating a letter to clients asserting that Storm had sole responsibility for managing it and the bank's clients' margin loans. Justice Greenwood declined to rule on the matter but referred it for trial on January 9, 2009.

The committee will be aware that on the day before this case was due to be heard the bank foreclosed on Storm Financial and forced it into voluntary administration. As a result, this matter remains unresolved.

Despite this, the bank's actions in retreating behind what they refer to as a 'Commercial Agreement' that existed between the bank and Storm and also referring to the terms and conditions of their margin lending product to justify their actions in "sitting on their hands" while the financial well-being and the lives of their clients were being destroyed was, in SICAG's view, unconscionable.

Hundreds of SICAG members claim they could have met their margin calls and continued to trade in the share market if they were given the opportunity. Sadly, they were never given that opportunity.

Enforceable Undertaking

Storm and its agents were prevented from communicating with their clients while negotiations were playing out between ASIC and the principals of Storm surrounding an Enforceable Undertaking that ASIC sought to have imposed on Storm during December 2008 for a period of 12 months.

The reasons for ASIC seeking the EU were outlined in an email from Mr Vaughan Groves of ASIC's Stakeholder Services Division to Storm's Cairns franchise owner, Mr Gus Dalle Cort. He stated:

- *ASIC was looking to negotiate an Enforceable Undertaking with Storm around 15 December, after Storm had been experiencing problems for some time. By October, Storm had been speaking with the CBA looking to get more funds to prop up the company and help*

out investors. As the market kept falling, Storm put out a letter seeking authorisation to switch clients' investments into cash. In December ASIC was making inquiries and announced our investigation on 12 December.

- *An Enforceable Undertaking (EU) was a way for Storm to agree to address ASIC's concerns without going through a lengthy court process.*
- *ASIC was concerned that the Cassimatises were not giving clients the right advice; they were suggesting that they could sue the CBA and get the clients' money back and telling them not to deal with the banks.*
- *The EU was about getting Storm clients to other advisers, however, we did not ultimately execute an EU and Storm went into administration.*
- *Unfortunately Storm has exaggerated this as an excuse for what went wrong.*

End of email

Regardless of whether the EU was imposed by ASIC or accepted by Storm in good faith, as alleged, the effect was to "gag" Storm at the very

time that clients were clamouring for information, leaving them in a vacuum.

In regard to Mr Groves' last comment, SICAG can very definitely testify that the distress and bewilderment it caused to Storm's clients cannot be '*exaggerated*'.

It has been suggested to SICAG that ASIC's action was taken in collusion with the CBA , the motive being to simply render Storm impotent in their ability to encourage their clients not to pay the negative equity, as was the perception by CBA of Storm at the time.

Just who had the legal responsibility to inform Storm clients they were in margin call or that their portfolios were being sold down will be decided in another forum, but the consequences for the clients were disastrous and life-changing.

SICAG members would be very interested to learn the identities of the purchasers of their shares when they were sold down.

Australian "fair go" concept

SICAG feels strongly that the actions of the banks leading up to and subsequent to the collapse of Storm Financial were unconscionable. In addition to that claim, we believe the banks' actions were inconsistent with the Australian concept of a "fair go" – that is, the fundamental sense

that in an egalitarian society, everyone deserves a minimum level of social justice. This is what is enshrined in the phrase: **"Justice must not only be done, it must be SEEN to be done".**

This philosophy was probably best demonstrated in the movie "*The Castle*" where the treatment that a human being had a right to expect from another – despite what legislative definitions exist – was cinematically explored.

Keeping in mind that margin lending was an unregulated product at the time of the Storm collapse, it seems to SICAG that in the absence of any legislative protection for consumers, clients therefore could reasonably expect to be treated with a standard of fair play in respect to the welfare of their finances and their lives. The question needs to be asked: What redress does the community have to protect their interests against a bank? En masse, they may engage in what is referred to as a "run on the banks" by withdrawing their deposits, thus placing the banks in a precarious position. We saw what happens when this possible action becomes apparent: the Government of the day stepped in and gave a taxpayer-funded guarantee to the banks to protect them against what may be termed the malevolent, ruthless and vindictive actions of the community. Now if we reverse the roles for a minute, the very same set of circumstances that caused the disgruntled citizens to threaten a run on the banking system now result in the citizens watching on helplessly as their financial wellbeing is destroyed simply because the bank says

they can. In our minds, this scenario conjures up a distortion of the fundamental principle of social justice or a "fair go".

The Australian Government can and did rush to the aid of "The Four Pillars" during the latter part of last year by guaranteeing funds and borrowings to ensure a fundamentally strong banking system. At the same time those very same banks failed dismally to accord the same latitude to the "mum and dad" Australians who guaranteed the banks' security!

Where was the goodwill and the sense of "fair go" when these life-destroying decisions were made in the dispassionate boardrooms of the big banks?

The term for such an imbalance is "moral hazard" which is defined as the prospect that a party insulated from risk may behave differently from the way it would behave if it were fully exposed to the risk. SICAG believes CBA/CGI have conducted their affairs in relation to Storm Financial without regard or respect for their customers or indeed the Australian general public. Despite recent public utterances by CEO Ralph Norris of mistakes and resolution, the CBA/CGI stand condemned as a heartless, faceless organization that acted with undue haste and contempt for its customers who were left in a vacuum of confusion, despair and, in some case, utter devastation.

This can never be allowed to happen again.

Recommendations

1. LENDER LIABILITY – "A DUTY OF CARE"

RECOMMENDATION: SICAG recommends that "Lender Liability" legislation be introduced to ensure banks have a Duty of Care/ Fiduciary Duty to their customers. Where a bank fails to exercise such a Duty of Care the bank's security should be invalidated.

Implementation of this recommendation would result in bankers becoming prudential bankers rather than reckless lenders, which was the primary cause of the current World Financial Crisis.

It is our belief that the failure by banks to exercise a "duty of care" when they chose to aggressively market the availability of almost unlimited finance in conjunction with Storm to borrowers, many of whom were economically unsophisticated, is the root cause of the "Storm disaster". This, when combined with "bonus incentives" for lenders to ignore prudential lending practices, created "the perfect financial storm".

As far as the banks and Storm were concerned, profit was the primary motive thus leading to the rationalisation of all form of corrupt and immoral behaviour.

We have no doubt that this Inquiry will discover banks lent large sums of money without any regard to the ability of the borrowers to repay the loans in the event of a substantial market correction.

Banking Law at present has enshrined the principle that banks do not have a "duty of care". Banks have spent millions in legal fees to ensure that any case that may result in a judgment setting a precedent against this principle is aggressively defended.

The following is an extract from an excellent paper by Special Counsel Elisabeth Wentworth to the Banking and Financial Services Ombudsman. The paper is undated and Ms Wentworth has advised some of the conclusions may have been overturned by more recent court judgments, however we believe it is pertinent to an analysis of how the Storm financial disaster occurred.

The complete paper is attached to this submission and is an excellent summary of the complexities faced by unsophisticated borrowers when dealing with banks and resolving complaints.

Extract from "Essential Banking Law and Practice" By Elisabeth Wentworth, Special Counsel to the

Ombudsman, Banking and Financial Services Ombudsman Ltd.

Does the bank owe a duty of care?

The duty owed by a bank has been expressed as a contractual duty 'to exercise reasonable care in carrying out the bank's part" of the contract. The standard is that of the reasonable competent banker acting in accordance with accepted current practice. Such a duty may, in limited circumstances, include a duty to question an otherwise valid mandate, e.g. a cheque validly drawn and signed by an authorised signatory.

Does the bank owe a fiduciary duty?

The banker-customer relationship is not one of the accepted fiduciary relationships and the contractual duty of a banker to a customer is not a fiduciary duty, except in special circumstances. In the usual course, the bank is entitled to prefer its own interests to those of the customer, unlike a trustee or a professional adviser such as a lawyer, and does not have a duty to provide advice. This can come as a surprise to customers who may believe that a bank has a duty to advise them that a transaction or product is not in their interests, for example:

- ☑ That a proposed business purchase is inadvisable because the business, to the knowledge of the bank, may not be sound;
- ☑ That a proposed property purchase is inadvisable because, to the bank's knowledge from its valuation report, the value of the property is less than the purchase price; or

- ☑ That there may be other loan products which are more advantageous or which are more suitable to the customer.

A bank, however, does not usually have such duties and cases in which a bank lending to a customer comes to occupy a fiduciary position in which it must prefer the customer's interests to its own are rare. In cases where a

bank has been found to have assumed a fiduciary duty, the common thread is that of some special feature in the facts: in simple terms that the banker has stepped, or been propelled by circumstances, out of his or her usual shoes and has engendered in the customer an expectation he or she will advise in the customer's interests.

The case of ***Commonwealth Bank of Australia v Smith*** is an example. In that case the borrowers were inexperienced and accustomed over a long period of time to rely on the bank manager's advice. The bank manager gave advice when sought about the viability of the business they proposed purchasing, describing it as "a good buy". His advice included discouraging other sources of advice. And the geographical context was a small town. The facts will therefore be crucial.

End of extract

Most reasonable thinking finance consumers would be rightly alarmed to discover that a bank may <u>legally remain silent</u> even when it has knowledge that the financial transaction proposed could be perilous to the consumer.

We can think of no other situation where such a lack of duty of care is enshrined in the law.

In the Storm disaster, banks knew or ought to have known that the margin lending model used by Storm was only suitable for sophisticated investors with substantial cash reserves.

This was not normal lending – the model depended on "double leverage", borrowing against the family home to provide the deposit for a further "margin loan".

Marketing such a high-risk investment model to pensioners and retirees without a detailed level of **prudential risk advice** shows a callous indifference to basic principles of good banking practice. Banks have justified their right to remain silent by hiding behind third parties to provide so-called advice. However when the third parties such as Storm have a conflict of interest, such advice will always be problematic.

2. BONUS PAYMENTS

RECOMMENDATION: There must be a clear division between "selling of financial products" and the provision of prudent "advice". If a bonus payment is to be made it must be declared to the borrower. Banks must provide "plain English" documentation explaining the potential risks of financial transactions. Internal audit and credit policy powers must be strengthened to ensure prudential banking practices are adhered to. Regular audits by ASIC of both the internal and external audit process will ensure the integrity of the audit process.

During the 1980s all the major banks moved from being "service providers" to "sellers of financial products". Personnel management systems required annual setting of business

objectives that were linked to substantial bonus payments. Bankers became “used car salesmen”, their primary concern being the selling of financial products and receipt of bonus payments.

This culture has led to many problems for the banking industry not the least of which is the current world financial meltdown.

An example of this culture occurred in the 1980s when banks saw a way of circumventing the tight monetary controls and high interest rates by aggressively marketing “Foreign Currency Loans”, predominantly in Swiss francs.

Farms and small business people were targeted. As they had been used to their bank manager being a trusted member of the community, they accepted his advice. Although many managers had little comprehension of the massive risk associated with an unhedged foreign currency exposure they were compelled to aggressively market the loans to “prime” customers in order to achieve business targets and of course bonus payments.

When the Australian dollar collapsed in mid-1985, borrowers’ loan exposure doubled and banks moved aggressively to realise on their security. Over the next 10 years borrowers and banks fought many cases in the courts and banks used their financial muscle to destroy many borrowers.

It was not until confidential documents known as the "Westpac Letters" were leaked to the media and the Australian Parliament that the House of Representatives Standing Committee on Finance and Public Administration held an Inquiry and published their recommendations in November 1991 – "**A Pocket Full of Change**".

Unfortunately, few lessons were learnt from the Inquiry and although the Inquiry recommended the "Westpac Letters" be referred to the National Crime Authority to examine the fraudulent admissions made in the documents no such referral was ever made (para 17.208). We are now seeing the results of this failure to act decisively in the present Storm Financial disaster.

A reading of the Inquiry report paragraphs 17.1 to 17.208 will confirm this view.

Paragraphs 17.109 to 17.124 examine the payment of bonus payments or incentives to bank personnel to market the loans. Banks denied the payment of bonus payments however after a bitterly fought interlocutory battle over the production of personal records in ***Thannhauser-v-Westpac -*** http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/cth/FCA/1991/608.html?query=title(Thannhauser it was revealed that the manager charged with the responsibility for

warning borrowers of the risk associated with the loan had substantially exceeded his business objectives for the substantial benefit of Westpac and been paid substantial bonus payments. In his judgment in favour of Thannhauser, Justice Pincus concluded that he could not believe the bank's witness when he said he had disclosed all the risks when on the other had he was aggressively marketing the product in terms of his business objectives. Mr McLennan (consultant to SICAG) and former Personnel Manager of Westpac, has advised that such business objectives were linked to substantial bonus payments.

Since then the bonus system has pervaded the entire financial system, a cancer that encouraged blindness to prudential bank lending, audit supervision and credit control.

The proliferation of "Mortgage Brokers" earning bonuses and commissions has provided an environment where prudential banking practices are ignored.

3. CODE OF BANKING PRACTICE

RECOMMENDATION: SICAG recommends that legislative changes resulting from this inquiry be incorporated into the existing "Code of Banking Practice" and enshrined in legislation. If banks truly subscribe to the "Code of Banking Practice" they should have no objection to having it enforced through appropriate legislation.

4. LITIGATION COSTS

RECOMMENDATION: Finance and banking consumers must have access to a consumer organisation that incorporates the concept of a no-cost or low-cost "People's Court" that has coercive powers enforced by legislation to investigate complaints against banks.

Banks have a disproportionate advantage over consumers within the legal system as they have vast sums to fight any challenge in the courts.

Banks control a borrower's means (their money) to fight them and they use ruthless tactics to ensure legal costs are beyond the means of most borrowers wishing to challenge them.

The Banking Ombudsman scheme is seen as compromised as it is funded by the banks; therefore, consumers have little faith in its impartiality. Despite many Storm investors lodging complaints with the Financial Ombudsman Service (FOS), to our knowledge none has been resolved satisfactorily. At SICAG meetings in Queensland it seemed to most attendees that presentations made by FOS targeted what they could **NOT** do rather than what they **COULD** do for aggrieved Storm investors.

We understand this concept is presently under consideration by the Government as an enhancement to ASIC. We strongly support such a move to strengthen consumer rights.

Banks should be required to pay a levy according to the number of complaints made against them, to offset the cost of investigating complaints.

5. STRONGER REGULATION

RECOMMENDATION: Watchdogs such as ASIC and APRA (or perhaps a new body that melds these two organisations into one) need to be given more resources and greater legislative power to investigate and prevent disasters such as Storm IN ADVANCE. Penalties for breaches of regulations should be prohibitively harsh to dissuade high-risk schemes and shady operators.

6. PROFESSIONAL INDEMNITY INSURANCE

RECOMMENDATION: Investment advisory companies must be required to take out adequate professional indemnity insurance before being issued with a licence to practise. The level of insurance cover should be based on a sliding scale ranging from a base level for start-up firms rising to levels commensurate with the firm's total investment portfolio measured annually. The base level should be high to dissuade fly-by-night operators.

7. STANDARDISED PLAIN ENGLISH DOCUMENTATION

RECOMMENDATION: SICAG recommends that lenders be required to develop a set of standardised, plain English loan documents common to all lenders so that borrowers can compare "apples with apples". Current documentation varies from lender to lender and is extremely difficult to interpret.

Document ends