SECOND SUPPLEMENTARY SUBMISSION

an investor in the City Pacific First Mortgage Fund and the City Pacific Income Fund

Inquiry into Financial Products and Services in Australia

Parliamentary Joint Committee on Corporations & Financial Services Department of the Senate Parliament House - Room SG - 64

"I BLAME THE MANAGER, I DO NOT BLAME THE MARKET"

"Bloody Stupid Me"

http://www.news.com.au/heraldsun/story/0,21985,22030091-664,00.html

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SECOND SUPPLEMENTARY SUBMISSION – 2009 REVIEW OF MANAGED FUNDS

Introduction

In my previous submissions I have referred to what I would regard as the CBA's wrongful extension of the First Mortgage Fund's facility from $150m to $240m on 1 September 2007. I believe that the Commonwealth Bank of Australia ("CBA") should not have extended the facility in circumstances whereby the First Mortgage Fund ("FMF") was unable to repay the existing $150m facility.

In any event, some time in early 2008, after extending the facility on terms that the FMF was unable to comply with. The CBA pressed the manager of the FMF (City Pacific Limited ("CPL")) to replace the CBA facility with other debt providers. In an extremely difficult market, CPL entered into an arrangement with a number of so called 'co-investors'.

On 18 March 2008, CPL notified the ASX that 'institutional co-investor' Fortress Credit Corporation (Australia) II Pty. Ltd. ("Fortress") had 'co-invested' approximately $100m into the fund to acquire a parcel of loans at their 'book value'. On the 19 March 2008, Ben Butler at *heraldsun.com.au* reported that CPL will become a 'joint mortgage lender'.

It is interesting to note that this same article discloses that "... An ASIC spokeswoman said the fund could not raise money from investors as it does not have a current product disclosure statement. ..." Mr. Butler also reported that the FMF would receive $100m over a period of time. On 6 June 2008, Michael West of *businessday* fame reported (in part) that Fortress was a 'white knight'.

On 22 September 2008, CPL stated (in part) that the Fund didn't have 'any finance facility or any loans' with Fortress, a statement which I consider to be misleading because it omits to disclose the true impact of such loans. Fortress will take over the obligations of the FMF (pursuant to the 'idiotic fundamentals of the FMF) and make further advances to these lenders who are already in default.

In order to recover any (if any) shortfall of the new advances, fees, charges, and outstanding amount due from the loans 'acquired from the FMF', the institutional 'lender/investor' will take first bite from the fund's assets standing as surety. Since these loans were 'acquired' in March 2008 prior to any impairments, and the money paid to the FMF by the co-lender as repayments is already accounted for in the FMF, then the value of the 'first bite' will be an immediate loss to the FMF and further devalue the FMF with REAL losses.

On 11 June 2008, in a document entitled 'Fund Update 11 June 2009', CPL disclosed the exact nature of the institutional co-lending arrangements with an 'institutional investor'. In March 2008, CPL withdrew its investment in Grande Pacific by the insertion of another 'institutional investor', Teak Capital (Singaporean). While I complain of this action too, I complain on two grounds, (1) that CPL took its money out from a second mortgage position of total loss while the FMF had a first mortgage position (that is, took its money ahead of the FMF – a clear beach of s.601FC(1)(c)), and (2) gave investors a false impression of exactly what had happened.

I think it would be fair to say that most investors in the FMF believed that Fortress was a 'white knight' and a 'co-investor' because of media releases made by CPL's CEO, Sullivan. Further, I believe that most investors in the FMF did not realise that CPL had actually 'saved' its second mortgage based investment in the ailing 'Grande Pacific' by effectively negating the FMF's 'first mortgage' priority.

I find myself learning this game bit by bit, and as time passes, it becomes clearer and clearer to me that each of CPL and the CBA carried out wrongful acts detrimental to the interests of investors in the FMF. I believe that ASIC was at best a bystander, that the auditors were at best looking towards CPL's interests rather than interests of the members of the FMF, and I believe that the Public Trustee of Queensland ("PTQ") should have given some warning to members in relation to these 'co-investors'.

I feel that the FMF is going to suffer further losses attributed solely to the fact that the game was allowed to go on 'out of the playground', that is, that Fortress, Teak, and perhaps others were able to continue on as CPL had done, but without reporting their activities to members of the FMF: A fact not reported to members of the FMF by either of ASIC, KPMG, PTQ, or CBA until done so by CPL in the 11 June 2009 Update (RG45).

'Co-Investment' in the FMF

Fortress Credit Corporation (Australia) II Pty. Ltd. ("Fortress")

On 18 March 2008, in an *ASX release*, CPL stated (in part):-

"... Further to our announcement of 12 March 2008, City Pacific Limited (City Pacific) confirms that Fortress Credit Corporation (Australia) II Pty Ltd (Fortress) is the institutional co-investor in the City Pacific First Mortgage Fund (Fund).

As stated previously Fortress will co-invest approximately $100 million with the Fund in a portfolio of large first mortgage loans from the Fund at their book value.

Fortress will become a joint first mortgage lender with the Fund on the portfolio of loans. City Pacific confirms that the initial $30 million co-investment was settled on 14 March 2008.

The co-investment will release $100 million back to the Fund which will be used to continue the investment objectives of the Fund. The Fund will continue to build value by introducing and developing long-term relationships with institutional investors and partners. ..."

I believe that the preceding excerpt contains a misleading statement by CPL in that it gives the reader the impression that Fortress is a 'co-investor' and 'joint-first mortgage lender with the fund'. I remember at that time thinking it was a good idea because the manager had shifted some of the loans (and their associated risks) out to a third party/parties and brought some money into the FMF. I'd guess now that I was thinking exactly what CPL wanted me to think, because I had been misled.

What surprises me is that no one really pointed out the omissions from the statement. ASIC speaks of 'consumer education', well, our experience with CPL's carefully worded statements show that the combined 'education' of ASIC, the media, PTQ, and the auditors didn't help us: so, what is the value of 'education' to us?

The CBA must have known, or ought to have known, that the practice of co-lending would put the FMF at risk, so must have the auditors, and so must have ASIC – but what surprises me most is how far the media were off the mark. It seems to be that ASIC lacks the attribute of 'suspicion': the capacity to suspect something is wrong.

CPL's omission as to the fact that Fortress would carry on the FMF's obligations to these lenders, that the lenders were already mostly in default, and that the fund would be liable for any shortfall by the lenders were not raised as a concern by any entity on which we relied, so why would we see a problem?

What was allowed to happen here was that Fortress could go and play CPL's game outside of the 'playground' and away from the gaze of spectators and allow an increasing debt to lay dormant until such time as a loan would be foreclosed and an asset sold. The shortfall would be borne by the FMF and the loss realised. A very shady deal indeed. In this way, the 'co-investor' would appear to be the 'bad guy'.

The following article reported nothing more the 'co lending arrangement', no mention of the negative impact on the FMF. I think that it's been a mistake for investors to rely heavily on what the media reports because so often it is no more that a replication of part of the carefully worded intentions of those they report on.

On 19 March 2008, Ben Butler reported at *heraldsun.com.au* (in part) that:-

"... An ASIC spokeswoman said the fund could not raise money from investors as it does not have a current product disclosure statement.

The fund has received $30 million from US financier Fortress Investment Group, City Pacific announced yesterday. Another $70 million is due by the end of the month.

In return, Fortress is to become a "joint first mortgage lender" on a portfolio of loans from the fund's book. ..."

Michael West (next excerpt) went so far as to say that Fortress was a 'white knight'. Now, many people relied on Mr. West's statements and I would have thought that this statement would have given members of the FMF unfounded comfort in believing that Fortress was a 'white knight' when it was in fact quite the opposite.

On 6 June 2008, Michael West in *businessday* (in part) reported:-

"... Redemptions to the flagship fund were frozen soon afterwards and the company was forced to find a white knight, in the guise of the US Fortress Group, to inject $100 million in capital into its fund. ..."

Scott Rochfort has been a respected reporter with regard to the FMF, and I believe that one will easily see just how confusing these reporters can be. In the following excerpt, Mr. Rochfort states that the $100m is an 'emergency loan' without any explanation as to the impact of such an 'emergency loan' on the FMF.

On 22 September 2008, Scott Rochfort in *businessday* (in part) reported:-

"... The fund also lent $11.8 million in April to a project run in partnership with the troubled developer Raptis. This was one month after fund redemptions were frozen. That month the FMF sought a $100 million emergency loan from Fortress Credit Corp. Phil Sullivan, City Pacific's managing director, declined to talk and hung up on the *Herald*. ..."

On 22 September 2008, in reply to Scott Rochfort's article CPL in an *ASX Announcement* (in part) reported:-

"... The Fund does not have any finance facility with or any loans from Fortress Credit Corp ("Fortress"). The Fund and Fortress have a co-lending arrangement whereby they have agreed to jointly loan funds to three borrowers. Fortress is a lender to those borrowers and not to the Fund.

Such syndicated lending is common practice on large scale projects and the Fund has undertaken similar co lending arrangements with mainstream banks on a number of projects in the past. ..."

Now, I consider the preceding statement to be misleading. Clearly the statement is meant for the ignorant, because anyone 'in the know', would understand what CPL had done. The statement 'The Fund does not have any finance facility or any loans from Fortress' was meant to deceive (as was disclosed in the 11 June 2009 update whereby CPL clearly reported that Fortress has 'first priority' over fund assets). I place myself in the ranks of the 'ignorant' at that time because we were just unable to 'see the forest for the trees'.

In the following excerpt, Michael West hinted at Fortress' true impact on the FMF, and gave a partial clue to the impact, that Fortress (still called a white knight) 'would have first dibs on its $100m ahead of unit holders'.

On 10 December 2008, Michael West in *businessday* (in part) reported:-

"... Further, Sullivan brought "white knight" Fortress on board with $100 million in funding early this year. Now the white knight has first dibs on its $100 million ahead of the unit holders. ..."

On 11 June 2009, CPL disclosed the true nature of this 'white knight' in a document entitled '*Fund Update 11 June 2009*' (in part) on the top of page 4:-

"... ***Co-lending arrangements***
On 18 March 2008, the Fund entered into a co-lending agreement with an institutional investor (Fortress Credit Corporation (Australia) II Pty Ltd). The agreement provides that the institutional investor will co-lend approximately $100 million with the Fund in a range of first mortgages currently held by the Fund. The institutional investor acquired an interest in those mortgage loans at their book value by providing a loan facility to the borrowers.

The institutional investor became a joint first mortgage lender with first priority ahead of the Fund with the proceeds of $100 million received by the Fund by way of loan repayments, $20 million of which was

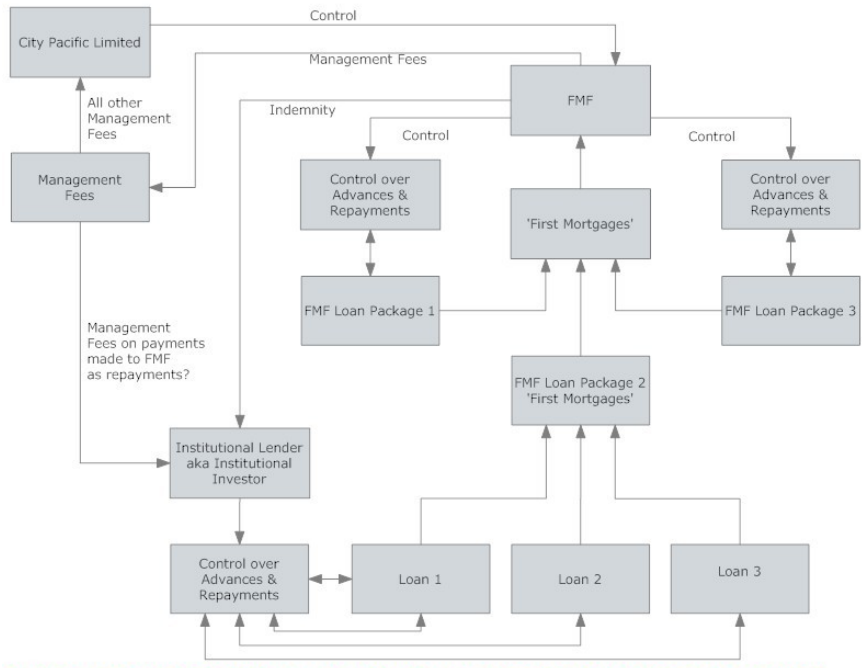
advanced directly to the borrower by Fortress thereby reducing the Fund's commitment. The $100 million loan repayments were used to continue the investment objectives of the Fund.
As at 31 December 2008, the institutional investor has co-lent $65,586,736 with the Fund on four separate loans which have different maturity dates. There are three borrowers overdue on their Loans which were due to be repaid on 30 June 2008, 31 December 2008 and 4 February 2009.. Of the four loans, the institutional investor has been repaid in full in respect of one of them and of the other three, the security properties are in the process of being marketed for sale.

There is the risk to members that if these borrowers do not pay back their facilities, the institutional investor could exercise its rights as mortgagee ahead of the Fund. To date ongoing negotiation with the borrowers has occurred in conjunction with the institutional investor, City Pacific and the Fund. ..."

To me, this statement meant nothing at the time, in fact I found the whole document difficult to read. Now I know its a RG45 disclosure and the section on 'co-lending arrangements' tells me that Fortress gave money to the FMF in consideration that they 'acquire' a parcel of loans from the FMF.

Fortress will continue with the FMF's obligations to these lenders and in the event of foreclosure, will take first rights (ahead of the FMF) on FMF assets securing the respective Fortress loans.

I believe that Fortress is in fact acting as an agent for CPL or as a cohort (*de facto* manager) with CPL in the management of this 'parcel of loans'. In fact, they were sharing management fees paid by the FMF to CPL (I believe on the $100m), "... "The co-investment arrangements provide that both the institutional investor and City Pacific will share management fees arising from this $100 million loan portfolio and this will not materially affect the profitability of City Pacific." ..." (13 March 2008, *InvestorDaily*, Kate Kocher)



Note 1: The FMF 'indemnifies' the institutional lender to the extent of the BOOK VALUE of the Loan Package at the time the package was 'acquired' because the institutional lender has first bite of the assets held as surety.

Note 2: Because these loans were 'acquired' by the institutional lenders BEFORE 'impairments' (both the Ellis (not losses) type and the Sullivan (lost forever) types) were raised, the loans will come back and incur impairments on the FMF's asset value because impaired assets now stand as guarantee for unimpaired loans.

For example, a single loan worth $40m (of a total loan of $80m) might be acquired by the institutional lender and the assets covering the debt might have been valued at $100m (LVR 80%) at the time of 'acquisition' (pre-impairment).

The fund receives $40m for the 'acquisition' (if the full value IS paid, which I believe is unlikely.

Assume the impairment was 40%, then the asset is now worth $60m - the institutional lender forecloses on the loan and sells the asset at value $60m (to be generous), then the fund gets $20m from the proceeds.

The $20m is added to the $40m and the fund gets $60m which is a loss of $20m. **However, the $40m given to the FMF was already accounted for in the 2008 year, sothe $20m received is offset by a loss $60m of fund assets, therefore its a REAL LOSS of $40m from the $630m of impaired assets we believed had offset the quoted price of members' units.**

However, in the event the institutional lender has made further advances, then those advances (and interest and costs) if not paid, will come off the total too.

The mostly likely outcome in that scenario is that the fund will get nothing, or at best, next to nothing.

Remember, the institutional lender will take over the FMF's 'obligations' to the loan packages' lenders.

I constructed the above graphic to explain my view of just how these 'institutional co-investors/lenders' interact with the fund and just how the fund will incur debt as a result of debt recovery by the co-investors/lenders.

The 'upshot' for members is discussed below in 'The Upshot'.

Teak Capital ("Teak")

The following excerpt is taken from a CPL *ASX announcement* dated 30 July 2008:-

".... Co-investment arrangement with Teak Capital Partners and a foreign institutional investor City Pacific as responsible entity for the First Mortgage Fund ("FMF") has executed an indicative term sheet with Teak Capital Partners and a foreign institutional investor (Investors). The Investors will co-invest approximately $44 million in the Grande Pacific Broadwater project which is currently fully funded by the FMF.

The FMF benefits from the arrangement with the Investors as follows: 1. repayment of $30 million back to the FMF on or before 29 August 2008; and 2. the Investors assume the $14 million construction funding obligation for the project.

The agreement is subject to execution of satisfactory documentation and the completion of due diligence by the Investors with settlement expected on or before 29 August 2008. City Pacific is confident that the Investors will be satisfied with their due diligence and that the matter will proceed to completion as scheduled.

City Pacific as responsible entity of the FMF continues to build value by introducing and developing long-term relationships with institutional investors. ..."

On 31 July 2008, Nick Nichols of goldcoast.com.au reported (in part):-

"... CITY Pacific is pulling most of its cash out of the Grande Pacific Broadwater at Southport after finding an Asian venture capitalist as a replacement funder. The Gold Coast property financier yesterday said Singapore's Teak Capital Partners and an unnamed foreign institutional investor had agreed to pour $44 million into the 25-level seniors-only project which is nearing completion along Marine Parade. …

Mr Sullivan said that the initial investment by Teak Capital would cut City Pacific's funding commitment to Grande Pacific Broadwater by about two-thirds. ...

It also would see the return of $30 million to the frozen First Mortgage Fund before the end of August, while $14 million in construction funding would be assumed by the new financiers. ..."

One has to give some thought to the matter of our 'registered first mortgage' on Grande Pacific at Broadbeach. CPL entered into an arrangement with a Singaporean company, Teak Capital. This was at a time after the fund was frozen. CPL had money invested in the development (as a second mortgage), the FMF had heaps in there (as first mortgage).

The market was shot, and the FMF 'investment' there was in total jeopardy, yet, CPL (as manager for the FMF), took its money out (which would have been totally lost because of the FMF's priority over CPL's (Grande Pacific Limited's) second mortgage - how did it do that without cheating members of the FMF?

How did CPL pay out its second mortgage when that loan was subordinate to the FMF's first mortgage - easy, with Teak Capital which doubtlessly has first priority over the FMF - after all, why was $30m paid to the FMF by Teak Capital - was that $30m paid to the FMF as 'repayments' just like Fortress did? Did the $30m go back to CPL (after all, the goldcoast.com.au 'Foreign Financiers step in on City Pacific's Southport Project' article said CPL got most of its money back).

CPL's money was all but LOST, however, it shifted a creditor/s (Teak and another) in over the FMF's right and then CPL took its money back - is that a breach of s.601FC(1)(c) of the Corporations Act? Hey, ASIC doesn't care, so it must be okay for a second mortgage holder to beat a first mortgage holder - but, that's easy when the second mortgage holder is the manager of the first mortgage holder.

There is no way that Teak Capital would invest into the Grande Pacific development BEHIND the FMF - and in any event, why would it pay the $30m to the FMF, if it wasn't by way of repayments on a loan it took up (just as Fortress did)?

My guess is that impairments may have been hidden in these 'icebergs' of 'institutional investor (lender) loan packages' and that these impairments are yet to strike the FMF's unit value.

The Upshot

Since these 'loans' acquired by the 'institutional lender/s' are probably all in default, then they will detract from the FMF's opportunity to recover - for example, on Broadbeach, if the loan was $40m and defaulted by $10m, and the land was sold for $80m, then the fund would get $70m from a $210m++ loan. Sound good? How about if it was $45m? then the FMF would get $35m - is this a bargain?

There has been SIX problems for unit holders in this 'institutional (investor) lender' business - they are:-

1. by shuffling the UNIMPAIRED loans at 'book value' in March 2008, no impairment has yet to befall the FMF,
2. the loans do not have to be 'acquired' at 'book value', they could be acquired for less (leaving the co-investor/co-lender still to claim the whole of the value back from the FMF on default),
3. the FMF may now incur further costs and losses as a consequence of the transactions with this 'institutional (investors) lenders',
4. investors in the FMF may have been given an inflated value of units in the FMF,
5. lenders holding second mortgages may have been repaid in priority to the first mortgages held by the FMF (eg. CPL's return of its investment in Grande Pacific), and;
6. that the co-investor/co-lending was not done on an equal footing, rather all the risk remained fully with the FMF.

As previously stated, at first I believed that these 'institutional investors' were helpful to the fund, but with some degree of understanding and hindsight, I see that they were not. The CBA (again) got $100m of its money back but the FMF debt remained the same – contrary to the belief of many members of the FMF.

The debt (obligation to the fund) did not change at all. It was just a charade, a 'shell game'. Any shortfall in the $100m (or whatever value it is) due Fortress will come directly from the assets of the FMF - remember, they 'acquired' the debts at 'book value' (regardless of the cost they paid), so $100m unimpaired (book value) taken back from the impaired fund, is effectively applying another loss of $31m (plus costs, commissions, loss on 'acquisition' (if any)) to the fund because the $100m (unimpaired) buys back $100 (impaired) - so, the loss then crystallises [a $1 unimpaired = $1.67 impaired].

The fund cannot escape the loss even though the debt was taken from the fund in March 2009 [pre-impairment, post freezing]. Debt must be covered by assets and the assets are valued and accounted for against the debt, but, the true of amount of assets required to repay a debt can only be realised when is an asset is sold. With respect to differences between 'bank' debt and 'institutional debt', members of the fund :-

1. will be aware that a bank facility represents debt to the fund but may not be aware that the acquisition of an FMF loan by an institutional 'investor' is potential debt to the fund, and;
2. may be aware of the level of the bank facility (from time to time), but may not be aware of the level of the debt risk to the fund as a consequence of ALL of the institutional 'investors' transactions with developer lenders pursuant to the loan conditions agreed to by the fund and the developer lender.

The 'institutional lender' is able to come out of 'left field' and commence foreclosure without notice to members of the fund for an amount not known to members of the fund: a complete surprise, even with the issuance of an RG45. Given that debt is of great concern to members of the fund, the true nature of debt is a critical element in members' decision making processes when considering:-

1. changing a manager,
2. voting on particular proposals at a meeting,
3. gauging the quality of the manager's management of the fund, and;
4. gauging the fund's performance.

A 'co-investor' doesn't need to worry (as stated before) because the remainder of the fund adequately covers their debts, but whether or not anything is left for investors is another thing altogether.

My hope is that Fortress and the other 'institutional lenders' will be prohibited from exercising their rights to a higher priority than the FMF.

The Law

As I understand the Corporations Act (Cth) 2001, Section 601FC(1)(c), the manager must put members' interests before the manager's own interests.

At every turn, CPL (as manager for the FMF) put its own interests before members' interests at the following times:-

1. the de-consolidation of the FMF from CPL's accounts in circumstances when CPL knew, or ought to have known, that the FMF was going to incur substantial losses,
2. by implementing the 'idiotic fundamentals' of the FMF the manager was able to keep his ailing (even dying) developments on the drip feed,
3. when CPL withdrew its investment from Grande Pacific even though it held a second mortgage subject to the FMF's first mortgage,
4. when CPL took $17.8 from the FMF to go to CP1 and then to CPL in March 2009,
5. when CPL took $18m from the FMF to go to CP1 to go to the CBA in March 2009, and;
6. when CPL entered into agreements with various 'institutional co-investors/co-lenders' to carry on the 'idiotic fundamentals of the FMF' putting more and more of investors' money at risk.

I believe that CPL breached s. 601FC(1)(c) in all six circumstances and ASIC didn't investigate even one of those events. All events occurred at a time when the CBA held fixed and floating charges over the FMF.

The Corporation Act (Cth) 2001, s. 601FC provides (in part):-

(2) The responsible entity holds scheme property on trust for scheme members.

Note: Under subsection 601FB(2), the responsible entity may appoint an agent to hold scheme property separately from other property.

(3) A duty of the responsible entity under subsection (1) or (2) overrides any conflicting duty an officer or employee of the responsible entity has under Part 2D.1.

(5) A responsible entity who contravenes subsection (1), and any person who is involved in a responsible entity's contravention of that subsection, contravenes this subsection.

Note 1: Section 79 defines *involved* .

Note 2: Subsection (5) is a civil penalty provision (see section 1317E).

(6) A person must not intentionally or recklessly be involved in a responsible entity's contravention of subsection (1).

Why would a co-lender continue to give advances to a lender is such a defaulted state? What is going on? Why are loans continued to be made by co-lenders to lenders who are in default?

This all seems very, very fishy (to say the least) - the loans went on for another year, more money was spent, we might have lived in a 'fools paradise' with respect to the value of the fund's unit value, and the manager the CBA, and the 'institutional lenders' made heaps in fees. What's the value for us? more losses.

In my mind, the CBA is responsible for the greater part of the losses incurred by the FMF because the CBA extended the FMF's facility from $150m to $240m in circumstances whereby the FMF was incapable of repaying the $150m plus interest back to the CBA.

Extending the facility, in the circumstances, was a reckless act by the CBA. [see the Storm cases to see a parallel with our case]. The CBA has a responsibility to ensure that the entity to which is loans money is able to repay that money in the 'ordinary course of business'. Further, the CBA was, or ought to have been been, aware of s.601FC(1)(c) and the manager's and its own obligations pursuant to law - see ss. 601(2), (3), (5), and (6) of the Corporations Act (above).

It seems to be a common thread in many of these sad cases (including Storm clients) that a lender (such as the CBA) lends money without due regard to the capacity of the lender to repay the facility. In the case of the FMF, it was clearly an impossible task to repay the initial $150m facility without regard to the extra $90m – so, the outcome wasn't a surprise, it was a 'cert' – the FMF's fate was 'etched in stone', we were doomed.

I would submit to the inquiry (and to ASIC) that these co-lenders ('co-investors' as CPL liked to portray them) should be subject to s. 601FC(1)(c), (2), (3), (5), and (6) (above). I believe that the FMF should stand in priority BEFORE and NOT AFTER the so called 'co-investors'.

Migration – Does it Stifle Independence?

In this interesting article 'Billion-dollar errors: lawyers shape-up to audit firms' by Adam Schwab, *BusinessDay, June 8, 2009* disclosing (in part):-

"... complex fraud is difficult to detect, especially in very large businesses, because of the sampling methods used by auditors. However, in some cases auditors appear content to authorise financial statements which are incorrect, due to incompetence, personal interest or a combination of the two. As with ratings agencies, the independence of auditors has been called into question, given that they are being paid by the very people they are supposed to be monitoring.

Auditors are officially appointed by a board's audit committee to review management accounts, but in many cases that company's board is on very friendly terms with its executive team. As such, questioning the auditors' conclusions may be akin to questioning the performance of management. …

It is KPMG which appears to have been most significantly implicated in a large number of high-profile collapses. …

At property financier City Pacific's 60 per cent-owned satellite CP1, its December 2007 half-year financial statements (which were reviewed by KPMG), contained a basic arithmetic error - that $145 million in borrowings coupled with $6.1 million in accounts payable added up to $125.4 million.

The chief financial officer of CP1's parent company, City Pacific, was Adam Purss, who was previously employed by KPMG in its audit and risk advisory section. Purss's principal client had been City Pacific. CP1's company secretary, Lee Danahay, had also worked in that section of KPMG.

By receiving significant audit, and non-audit, fees yet rarely seeming to blow the whistle on problems, auditors' independence and value are cast into serious doubt.

The clamour is growing for solutions - such as having the external audit function run by a government authority, similar to the auditor-general, or having ASIC, rather than a company's board, select and appoint the auditors from an approved panel. ..."

Personally I have no confidence in KPMG as the auditor for the FMF. Further I feel that the auditor seemed more aligned with the 'hand that fed it', CPL.

Members of the FMF have received no timely advice as to the real effect of the 'co-investors', nor of the 'de-consolidation', nor of Teak Capital, nor of the March 2009 transactions. The state of FMF as at the 30 December 2007 could have best been described as disastrous and yet the auditor did not bring any of these issues to investors who continued to make investments with the fund in a timely manner.

As the inquiry will be aware, management of the FMF has been passed to Balmain Trilogy pursuant to a adoption of a proposal at a meeting on 25 June 2009. This new manager has been at pains to:-

1. Maintain a relationship with the CBA rather than seek a new alternative debt provider;
2. Maintain a relationship with KPMG rather than seek an independent auditor; and,
3. Attempt to attract employees from the ranks of CPL.

I believe these acts have been detrimental to unit holders opportunity to seek objective legal assessments of the behaviour of the CBA, KPMG, and CPL with respect to unit holders' losses from the operation of the FMF.

It is going to be far less likely that the manager will look to 'upset the apple cart' by questioning the behaviour of the very entity (CBA) that it already gone out of its way to placate. In an letter to investors, Balmain Trilogy

stated (in part), under the heading 'Other Matters' :-

"... BalmainTRILOGY is in continuing dialogue with the Commonwealth Bank of Australia (CBA) regarding the Fund's loan facility. This has included a detailed submission on our capabilities, progress on management of the mortgage assets and the initial strategy for the management of those assets going forward. CBA has specified the content of a formal submission which will be delivered to the CBA prior to 20 August 2009. ..."

Balmain Trilogy released its 'initial strategy' to the CBA, and yet has not released that plan to members of the FMF. Already, the CBA is placed BEFORE members of the fund: a position that will make it less likely that any objective assessment will be made of the CBA's part (if any) in members' losses.

Under the heading 'Other Matters', Balmain Trilogy further disclosed (in part):-

"... KPMG will conduct the fund audit for the year ending 30 June 2009 and we are currently preparing a time line for preparation of tax statements that will allow completion of your tax returns for the 2008-2009 financial year. ..."

Again, how would it be possible for the new manager to objectively assess the performance of KPMG when the new manager has sought a business relationship with KPMG rather than seek to seek the services of an entirely objective auditor in the circumstances?

To cap it off, Balmain has engaged at least two account management staff from CPL while generally making welcome staff from the CPL.

I cannot think of any good reason as to why the new manager would seek to simply to replace itself as the 'head' of an organisation when so many investors in the fund feel they have been cheated by the substantive part of that organisation – where is the subjectivity? Are we doomed yet again?

Our Money – Their Game!

Self-Interest and Working in Concert

The world of the managed fund was a world filled with hope and optimism until mid-2007 when it all started to change and the ponzi-like structure of the FMF started to wobble from side to side as if struck by the tremors of diminishing participation, a slowing market, lack of cash, and bad press.

The CBA (the great initiator) had lent heaps to CPL ($100m), CP1 ($100m), and the FMF ($240m), with only the FMF having substantive assets to support repayment of its obligations to the CBA. I would submit that the bulk of the FMF's facility with the CBA was directed to CPL and its relatives - a very smart thing for CPL (and the CBA) to do because the risk fell on investors, not on the CBA, CPL, or CP1.

I would further submit that all times, the actions of the CBA and CPL were directed to protecting the loans given to CPL and CP1, without any consideration at all to the FMF facility. Why? Simply because the FMF was never the risk.

Why would the CBA (the once real 'Commonwealth Bank of Australia') put investors at risk if there was no need to do it? Well, it wouldn't, but there was reason, so it did: The reason was the uncertainly of repayments by CPL and CP1.

I believe the FMF's facility was extended, for the most part, in order that payments be made to CPL and CP1 so the CBA would have a greater opportunity of recovery of its loans to those parties.

What is the benefit of a bank lending to a fund with 'idiotic fundamentals' such as (1) lending to defaulters because there was no point chasing up debt, and (2) because the manager thought it better to complete developments regardless of whether the full amount could be recovered or not, and regardless of the state of the market. Well, a bank wouldn't lend to such an entity – but it would lend to such a fund if the loan was secured by assets and if it didn't care about the consequences for investors, if such a loan would further the bank's own long term objectives.

The CBA had conflicts of interests everywhere because it had its fingers in every pie; the manager, the fund, and the relatives. In the ordinary course of business if it lent only to the FMF then it would be concerned about protecting the asset value of the FMF to ensure its loan's security.

It would act likewise for CPL and for CP1 if those loans were in isolation and no way connected to each other and to the FMF. However, it was not the case – all the loans were interrelated and CPL was the common link: CPL was the manager of the FMF, and it had a controlling interest in CP1.

As stated, CP1 and CPL's loans were at risk, while the FMF had substantial assets backing its facility: a luxury that each of CPL and CP1 did not enjoy, and of course, the CBA knew it.

If the CBA was concerned about the FMF's assets then why would it allow CPL to incur more debt to the FMF at Grande Pacific? Because the debt was an effective transfer of debt from CPL, which enhanced CPL's opportunity to repay its debts to the CBA.

If the CBA was concerned about the FMF's assets, then why would it allow CPL to take the $17.8m from the settlement of the motel in northern NSW 'The Waves" and allow it the money to remain with CP1 with risky 'first mortgages' at Martha Cove in March 2009? It would, because that money was paid to CPL, which enhanced CPL's opportunity to repay its debts to the CBA.

Of course, the CBA knew that the $17.8m loan was more than risky for the FMF because it immediately threatened CP1 with insolvency. CPL then drained another $18m from the FMF to be paid to CP1 in order that the CBA be paid 'to protect the interests of the FMF'. I believe the CBA knew that the moment the FMF paid the $18m, that it was lost to the fund. If the CBA couldn't get the money from CP1, how could the FMF? (especially from absolutely useless second mortgages). Just a short time later came another demand for another $15m to be paid from CP1 to the CBA – yes, our $18m was indeed lost to the CBA.

The focus is clearly that CPL and CP1 have the capacity to repay the CBA without any regard whatsoever for investors in the FMF. In the circumstances, an ARM'S-LENGTH facility provider would NOT allow:-

1. an increase in the FMF's facility [the problem experienced by Storm clients],
2. the FMF take on debt effectively transferred from a second mortgage (Grande Pacific),
3. the receipt of $17.8m from a secure asset ('the Waves'), to be on lent to CP1`by the provision of 'first mortgages' (at Martha Cove) already compromised by another lender's loans, In fact an arms-length lender would not allow the FMF's first mortgages to be compromised – an issue that ASIC should investigate very closely,
4. the payment of $18m to CP1 to be paid to the CBA with the provision of useless 'first mortgages' and 'second mortgages' (at Martha Cove) already compromised by another lender's loans, and;
5. the acquisition of FMF loan/s by third party lenders to impact on the value of assets to the detriment of the FMF investors.

All of the above transactions were allowed because it was in the CBA's best interests to allow them to be made – and for no other good commercial reason – they were made in order to protect risky loans made to CPL and CP1, and all at the expense of investors in the FMF.

CPL gained a lot of press coverage at the expense of FMF investors – about the CBA's continual extensions of the facility being a 'vote of confidence' in CPL's management, but the truth was that the extensions were made to ensure CPL and CP1's capacity to repay – each act done by the CBA and CPL in concert were done to the detriment of FMF investors.

The following excerpt from Ben Butler's heraldsun.com.au article dated 20 February 2009 discloses that CBA controlled payments from the FMF, so its clear that while allowing CPL to transfer large amounts of money out of the FMF for the CBA's benefit, the CBA prohibited payment of distributions/redemptions to investors:-

"... Commonwealth Bank yesterday gave City Pacific an extra year to pay back more than $200 million in debt, and is considering the company's plan to restart distributions. … City Pacific chief executive John Ellis said CBA had yet to give approval to the distribution plan and had asked for extra details. ..."

Mr. Butler's article further cited Ellis (CPL CEO) as saying "... The bank had previously given City Pacific three sets of three-month extensions. Mr Ellis, who replaced founder Phil Sullivan in November, said the longer extension was "a vote of confidence in the company" ..."

An interesting comment since the only one of the three entities (CPL, CP1, and FMF) capable of repaying its debt (even in a worst case scenario) was the FMF. The fact was that CPL and CP1 were the CBA's concern and the only reason that it continued to lend to them was because of the FMF – this didn't stop CPL from distorting the truth and averring that extending the FMF's facility was 'a vote of confidence' in CPL.

I would guess that ever since the FMF become indebted to the CBA, the CBA exerted an extraordinary amount of control over the fund. After the facility was extended to $240m on 1 September 2007, I would guess that the control maximised. It would seem that CPL and the CBA really did work in concert to further their own aims, and in particular the aims of the CBA since it exerted to most control and had the most to lose.

Members of the cpfmf.org site forum wrote to the CBA on or about 17 October 2008 and received a reply dated 10 November 2008 which in part stated:-

"... as the relationship between banker and customer is subject to a strict duty of confidentiality I am unable to discuss arrangements between the bank and City Pacific Limited or City Pacific Mortgage Fund with you. I am sorry we cannot assist you further. Yours sincerely, Mark Sutton, Executive Manager, Credit Management. ..."

As this excerpt infers, '"it's a closed shop". Investors in the FMF have been misled, they have had to try to decipher obfuscated offerings from many sources, and have been largely treated as 'bottom feeders' who are not entitled to be told anything. This whole ordeal has been a real struggle.

I would submit that:-

1. It was the CBA's conflicts of interest that allowed CPL's conflicts to exist.
2. It was ASIC's complacency that created the environment for all of those conflicts to flourish.
3. The flourishing of those conflicts represented the consumption of our investments (our losses).
4. The auditors (both internal and external) raised no concerns.
5. The PTQ raised no concerns.
6. Since about August 2007, the FMF had become no more than a facade for a ponzi-like structure melting like an ice-cream on a hot summer's day.

Institutional co-investment is probably a very normal practice carried on between two equal partners wishing a common outcome and that is how the manager of the FMF portrayed their nasty deed – a common undertaking between two equal partners, a normal practice – but, the truth was that it didn't matter if the loan packages contained loans already in default, and it didn't matter how much it cost to get these 'emergency loans' (as Michael West later put them), because at all times the FMF was liable for them, and nobody told us that we were at risk all the time.

The media portrayed them as 'white knights', CPL portrayed them as 'co-investors'. CPL averred that the debt was written down by these institutional 'co-investors/co-lenders', and we believed them. I'm sure if members knew the reality that they would have gotten rid of CPL a year ago. ASIC stood by and done nothing, and the CBA was pleased because it got $100m of its money back.

This whole game has been a game of charades played at investors expense. There seems to have been a culture of lack of concern for investors' interests: a culture that accepted that if anyone was to lose, then it should be the investors, not the well educated, deep pocketed institutions.

The Development That Never Was

I have included (as Appendix "C" herein) the latest from the Queensland Supreme Court, Brisbane on the *ongoing battle over the Broadbeach land* known as 'Pacific Beach'. I believe this is only one of the many legal actions that will be proceeded with over the coming years by the FMF and its manager.

How could it be that such an epic production arises out of one loan to a development that never went ahead ? The loan was carried on for several years, rolled over and over with capitalised interest, and then part of it was 'acquired' by Fortress. Fortress eventually took legal action to foreclose the loan and proceeded to sell the property – foreclosure was inevitable, it was just a matter of time – a play for time.

It's a shame to see such a greedy fight when the whole thing was a sham right from the start. There was no development – CP1 walked away, Grocon walked away, CPL walked away, but the FMF was left to take the brunt of an onslaught from Fortress. It's a bloody mess and a lasting example of ASIC's failure as FIDO, corporate watchdog. Why didn't the auditor or 'outside auditor' (see two paragraphs down) bring this loan to investors' attention in 2007? Why didn't they query why such $108m was capitalising in circumstances where

the developer did not have the $600m firmly allocated BEFORE the loan was made?

At least it's clear to me that the FMF should not have lent the money to Foresight Acquisitions Pty. Ltd. ("Foresight") unless Foresight HAD the $600m firmly in place otherwise what was the point? Yes, Grocon 'bought' the shares in CP1 and was the 'preferred builder', but Grocon just walked away.

Yes, CPL had 33.3% 'ownership', but CPL just walked away too (and didn't declare it a related party transaction). I suppose that's what can be done with a 'ghost', it appears to those who believe, and it's doesn't exist for those who know the reality. it's just so easy to say it's there to give investors hope, and then it can disappear – but it's the $210m+ that the FMF invested (directly and via Fortress) that has really disappeared.

If Fortress' claim holds out, and if Foresight loses its case, any shortfall in the legal proceedings will eventually fall to members of the FMF too, because these costs will be added to the debt – If Foresight couldn't pay the debt on 'Pacific Beach', then certainly it cannot pay the legal costs. Again, they playing with our money and we can't do a thing about it: Our money – Their Game!

The $90m Loan That Broke the Back of a $1b Fund

I have no doubt that if the CBA did not advance the $90m to the FMF on 1 September 2007 that investors in the FMF would be in a much better position today than they are. In my view, the CBA's action alone contributed to the substantive part of the investor's losses in the FMF. The CBA should pay, and it should pay dearly.

There would have been no need for institutional 'co-investors/co-lenders' and action would have had to be taken to foreclose on those loans which should have been foreclosed on. The 'idiotic fundamentals' of the FMF would have had to come to an end. All under ASIC's watchful eye (see Appendix "B" - Monitoring the Actions of the Manager). The CBA has enabled the whole rotten show to continue, and to continue on losing investors' money day by day: In fact, the show continues on now with a new manager.

I just wonder why the 'external auditor' headed by an 'ex-senior ASIC investigator' agreed with the 'idiotic fundamentals of the FMF'? Why did this 'external auditor' agree that the 'idiotic fundamentals' were compliant with the FMF's PDS? In my opinion, this 'external auditor' needs to be looked at by ASIC too – here is the problem of 'Migration' again, does it stifle independence? Would ASIC really look at ex-ASIC?

The Tip of the Iceberg

One of the central issues critical to an investors assessment of a managed fund using accruals accounting is the declaration of the value of assets brought about by regular valuations. There must be an obvious tension between the loan to value ratio (LVR) on a particular property and the actual loan value given the manager's 'idiotic fundamentals' which allow for defaulter to be advanced loans until completion.

On 13 October 2008, the CPL advised members of the fund of the state of defaults in a graphic (shown below). It's clear that the defaults were:- February 2008 $160m, March 2008 $240m, and April 2008 $100m. - $500m, about half of the FMF's total value.

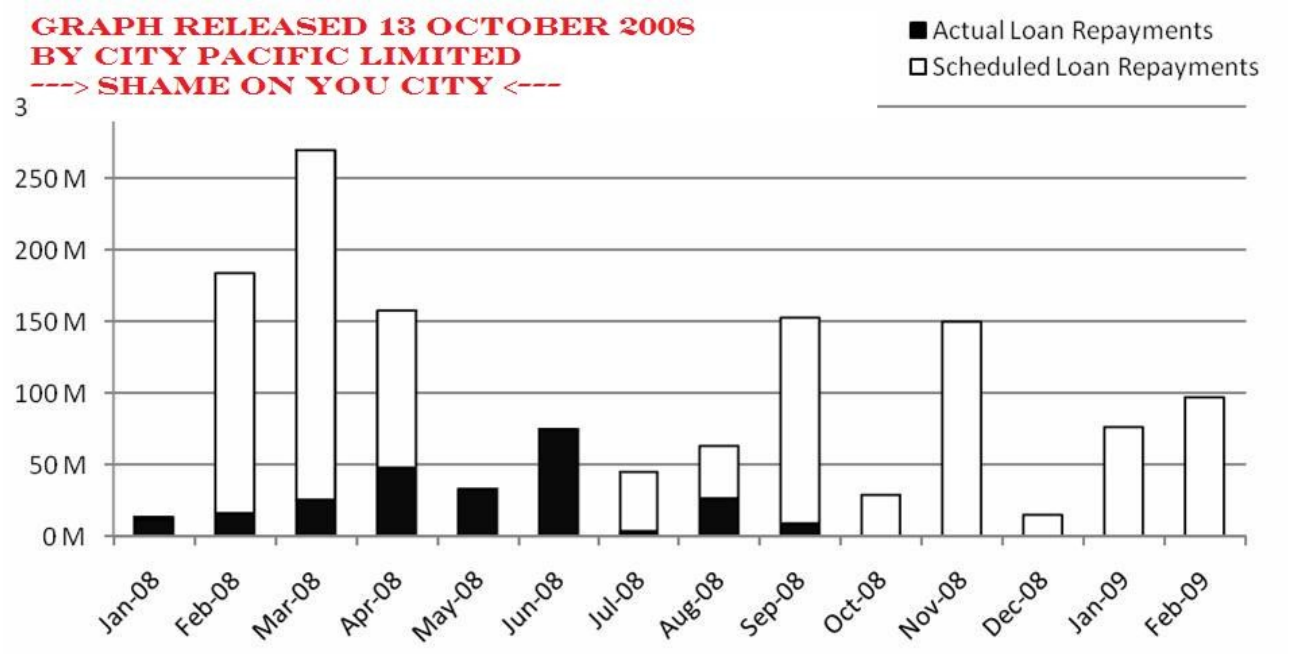
One has to wonder just how there were only $50m of impairment declared in the FMF as at 30 June 2008? As I understand it, the loans were 'saved' from default by capitalising the interest and rolling over the loans.

This allowed the manager to keep its management fee high and keep the related companies alive and well, at the expense of investors in the FMF. If one looks at Appendix "D" to the MFS PIF experience, "... As at September 2007, Pacific Finance recorded loans of $37m more than two years overdue, but still classed as not impaired because they were covered by the put option. The bulk of these loans were acquired at face value in the previous six months from related parties in Australia. This was bad enough, but when the MFS group collapsed under the weight of its debts in January 2008, it was the tip of the iceberg. ..."

In this world of the managed fund, somewhere between reality and fantasy, exists the investor, who has no real idea of what is happening – but auditors exist inside the reality, and so I just wonder why they accepted only $50m of impairments for a year in which defaulters rose to $500m, especially in circumstances when many of those loans have been rolled over for at least a year, with some more than 2 years?

The MFS PIF experience and the FMF experiences have more in common than not – the related party loans, the deferral of impairments, the 'co-investors', the facilities, second mortgages, the conflicts of interests, and of course, the auditors (KPMG).

This graphic shows some defaults from 2007 – 2008 financial year disclosed much later on 13 October 2008.



Conclusions

Education

It seems to me that CPL has been able to again engage in practices which deceive investors without any interference from the regulator, from the auditors, and from investors. Even the PTQ made no effort to warn investors of the risks associated with these 'institutional investors' (lenders).

CPL was able to pass over essentially defaulted loans, or the only good/reasonably good parts of overall defaulted on loans, to a third party, and thereby mislead investors into believing that the fund has not engaged in new loans or have a finance facility with Fortress, when at the end of the day, the fund was liable for any shortfall by any lender in the loan package 'acquired' by Fortress.

Why didn't ASIC see that such an arrangement was in fact capable of causing loss to investors – where did ASIC 'education' help us? It didn't.

Why didn't KPMG report to the ASX that CPL's statement contained omissions? Where did KPMG's 'education' help us? It didn't. These external auditors didn't offer any protection at all – is it a case of 'he/she who pays the piper selects the songs?'

How about the PTQ? Why didn't it inform investors in the FMF that such a move by CPL to make a deal over these 'packages of loans' would be likely to incur losses? Where did PTQ's 'education' help us? It didn't.

There will never be any good substitute for good policing and respect for the rights of investors. ASIC should adopt a proactive stance and take investors complaints seriously if (1) the complaint contains some degree of material evidence, or (2) a reasonably large number of complaints lacking substance but expressing real concern are received: I believe the old adage applies 'where there is smoke, there is fire'.

'Education' is fine, but being educated with respect to laws will never protect us from bad people, whether it is in the protection of our bodies, our loved ones, our property, or our bank accounts – yes, there are certain steps we can take, but in the end, we need a proactive regulator capable giving us protection.

Application of applicable laws to 'Co-investor / Co-lender' Contracts

I believe CPL engaged in misleading and deceptive conduct which should have been corrected by many parties, including ASIC.

In particular, the contractual arrangements with the "institutional investors' were wrongfully held out to members of the FMF as arrangements which would not incur further debt on the fund but rather would bring benefits to the FMF. In the case of Teak - "... 1. repayment of $30 million back to the FMF on or before 29 August 2008; and 2. the Investors assume the $14 million construction funding obligation for the project. ...", and in the case of Fortress - "... The co-investment will release $100 million back to the Fund which will be used to continue the investment objectives of the Fund. The Fund will continue to build value by introducing and developing long-term relationships with institutional investors and partners. ..."

Such misrepresentations allowed the manager to continue on its destructive path for at least until the new manager took over in June 2009. I would be surprised if the majority of investors in the FMF to this day realise the debts that will befall the FMF as a result of these institutional 'investors'. It was all just a 'shell game'.

I believe that CPL has breached s. 52 of the Trade Practices Act as well as s. 601FC(1)(c) of the Corporations Act, and any 'co-investor' has breached s. 601FC subsections as well by its actions in concert with CPL. The 'co-investors' become either (1) a *de facto* manager of the FMF, and/or (2) an agent for CPL and as such should have acted to place members interests before its own: Which they have not. The manager could not have bound the FMF by way of a loan, why should an agent or *de facto* manager be allowed to do so? In any event, I believe the 'co-investors' are party to CPL's breaches and are equally liable pursuant to the latter sections of s.601FC.

By the 'acquisition' of loans from the FMF in the circumstances, any 'co-investor' immediately impacts on the fund because a condition of the 'acquisition' was that a 'co-investor' become priority lender AHEAD of the FMF, thereby imposing potential debt on the FMF – a fact particularly omitted by CPL in its ASX release dated 22 September 2008. In the end, there could be only one outcome with defaulting lenders: foreclosure.

Application of Applicable Laws to Internal and External Auditors

With respect to matters raised in this second supplementary submission, KPMG and the external auditors failed to advise members of the FMF (to detail but a few):-

1. of the potential debt to be imposed on the FMF by way of these 'institutional investors',
2. that the 'idiotic fundamentals of the FMF' breached the FMF's PDS and/or Corporations Act s.601FC(1)(c) (as complained of in my submission),
3. that the rolling over of loans (enabled by the 'idiotic fundamentals of the FMF') :-

   (a) allowed the manager to defer the declaration of impairments and thereby wrongly

      (i) claim management fees on inflated fund asset values,

      (ii) misrepresent the true value of the FMF to investors, and;

   (b) caused investors in the FMF to lose more of their investments than they otherwise should have.
4. that loans made in circumstances whereby the FMF was certain to suffer loss (eg. 'Pacific Sands' at Broadbeach because the $600m to develop the land had not been secured therefore the development could never have proceeded.),
5. that the 'institutional investors' were gaining loans that were either at risk of foreclosure or likely to be foreclosed, or the best parts of defective loans (eg. 'Pacific Sands'), and;
6. that cash flow within the FMF was non-existent from about mid 2007 – many loans were entered into about September 2007 at a time when the FMF was incapable of supporting them and many were capitalised when they should have been foreclosed, investors were leaving, the market deteriorating, together with bad press – yet, not a word from any of the auditors. Certainly prior to December 2007, the FMF was INCAPABLE of functioning and no one said anything at a time when CPL's CEO Sullivan misled the market by his statements that the FMF was strong, when there is no doubt that

the auditors and Board of City Pacific knew that was not the case: Investors were allowed to be placed at risk to invest and to re-invest, all to satisfy CPL's vain hope that their dream would not die.

I believe that during the reign of CPL, the independence of each of the auditors was compromised and that the auditors worked with the goal of satisfying the manager, rather than working for the protection of investors in the FMF, otherwise why wouldn't we have been informed of the many problems within the FMF?

Now, with the new manager appointed, I believe that investors' expectations that an objective assessment will be made of the FMF's auditor and facility provider will be dashed by the new manager's apparent desire of wanted to simply put its own 'head' in place of CPL's 'head' on the FMF 'body'. Perhaps even the same ex-ASIC headed 'external auditor' will remain on the payroll.

I have included (as Appendix "A") a copy of text from ASIC's site as an illustration to show that auditors may fall far short of our expectations.

As the end game is always important, it's nice to see where the state of play is at this time:-

The winners are:-

For ex-CPL CEO Sullivan it's "... The prime mover behind the failing City Pacific financial behemoth - which has lost about $500 million of investors' funds - amassed a $26 million property empire while at the helm of the group, *The Australian* reports. City Pacific founder Phil Sullivan owns 16 investment properties - including 10 luxury Gold Coast waterfront homes - which he bought during the 11 years he was the group's managing director. ..."

For ex-CEO MFS PIF Steven King it's "... he still has Elysian Fields, although according to one media report in Australia, its holding company, Canungra Property, is subject to a charge held by a New Zealand firm Pacific Finance. ..." (from Appendix "D" below).

I am acutely aware that many issues here do not fall within the terms of reference of the inquiry but ask that they be considered and discussed. I make these submissions as an investor from information known to me from the media and from the manager. I would hope that ASIC would take my complaints seriously, investigate them in a proper way, and take steps to give investors the justice they deserve.

I would guess that as many as 100,000 individual Australians and New Zealanders have suffered economic loss in managed funds such as the FMF, with such losses mainly due to the greed and self-interested behaviour of many who were considered trustworthy.

I have included (as Appendix "D"), the MFS PIF experience.

ASIC should realise that knowledge alone does not protect against bad people and that the sorts of issues raised here are rather like a 'continuous wrongdoing' over time, sometimes years.

The wrongdoings are preventable, and if they are not prevented, then there is evidence everywhere and the wrongdoers are detectable.

The wrongdoers should be punished with restitution sought for those wronged.

Without punishment,there will never be a change in bad corporate behaviour.

Without restitution there will be no justice.

Thank you.

An investor in the CPFMF and CPIF

Suggestions

1. That the practice of allowing a 'co-lender' to acquire packages of loans from a managed fund be prohibited unless (1) such a practice is expressly permitted in that fund's constitution, and (2) that investors are fully informed as to the consequences of such loans.
2. In the event a manager or a relative of a manager is engaged in a second mortgage in a project in which the respective managed fund holds a first mortgage, then the second mortgage cannot be satisfied by any means that imposes any kind of obligation on that managed fund. (I note that in my first submission I suggest that related party loans be prohibited – in the event such a suggestion was adopted then this point is moot).
3. In the event of a change of manager, the applicable law should provide that the new manager engage the services of an alternative auditor.
4. Loan providers should be compelled (in the event they are not so compelled) to ensure that in the event a manager of a managed fund applies for a credit facility (or an extension to an existing credit facility), that the fund is capable of repaying all existing and requested facilities without any detriment to members of that managed fund.
5. With respect to 'institutional investor/lenders',

   (a) that when entering into initial agreements with such entities (should they be permitted), that the manager be compelled to disclose details of the party/parties, the amount/s, and the general conditions of the agreement be disclosed on the day of the signing of a formal contract to members of the applicable managed fund, and;

   (b) that ALL substantial transactions be likewise disclosed to members of that fund as they occur and on the RG45. For example, if an agreement was entered into within the period, but the agreement was terminated by consent or by repayment within the same period, then such transactions should be disclosed to prevent an institutional investor/lender to be utilised to incur a benefit on the manager of that fund.
6. That reliance cannot be placed on auditors to provide a safety net for investors unless strict guidelines are implemented to give a great degree of reliance on auditors work.
7. That the applicable law prohibit a bank or institutional lender from contemporaneously lending to entities in relationships such as the FMF/CPL/CP1 wherein conflicts of interests are simply unable to be managed.
8. That the manager of a managed fund be required to disclose the particulars of regular valuations of property including a description of each and its LVR in order that investors are kept up to date with the value of their investments, otherwise impairments might not be realised within a fund when they otherwise should be – manager's fees are generally calculated on the value of the funds under management and so managers might be motivated to hold back on impairments in order that their income not be reduced.
9. That ASIC, on behalf of members of the FMF take appropriate legal action against the CBA, Board of CPL, internal and external auditors, and the PTQ, seeking the recovery of all losses (including interest) suffered as a consequence of their respective actions/inactions (if any), misrepresentations/ omissions (if any), breaches of common law duties (if any), and breaches of applicable laws (if any).

Appendix "A" - KPMG Partners Provide Enforceable Undertakings

09-146AD KPMG partners provide enforceable undertakings not to practice

Monday 17 August 2009

ASIC has accepted enforceable undertakings (EUs) from three partners of KPMG's Perth office, Messrs Brett Charles Fullarton, Robert Charles Kelly and Jonathan Grant Robinson, who were involved in auditing activities relating to Westpoint Group companies.

The EUs provide that they will not practice as registered auditors for:

- Mr Fullarton – two years;
- Mr Kelly – eighteen months;
- Mr Robinson – nine months.

The EUs also provide that Messrs Fullarton, Kelly and Robinson must:

- participate in an additional ten hours of continuing professional education on audit-related matters during these periods;
- have their next three audits following these respective periods reviewed by KPMG's Partner in Charge, Department of Professional Practice- Audit; and
- pay ASIC's investigation and legal costs.

The EUs arise out of audits performed by the KPMG partners of Westpoint entities before the group collapsed in 2006. Investigations by ASIC have led to legal actions including penalties against a variety of parties linked to the collapse. A global mediation of ASIC's compensation actions for the recovery of investor funds is currently underway.

A separate action against KPMG, initiated by ASIC, seeks financial compensation to repay Westpoint investors for losses arising out of the collapse of the Westpoint Group.

DETAILS OF THE AUDIT CONDUCT

Details of ASIC's concerns in relation to the audits that were performed by the KPMG partners are set out below. The KPMG partners have acknowledged these concerns but do not accept them.

Mr Fullarton

Mr Fullarton signed unqualified audit opinions in connection with various entities within the Westpoint Group for the financial years ended 30 June 2002, 2003 and 2004.

As a result of its investigations, ASIC formed a view that the audits of the entities conducted by Mr Fullarton were inadequate and failed to comply with Australian Auditing Standards. ASIC's concerns in relation to the audits included:

- failure to adequately consider the appropriateness of the recognition of profit earned on each such project as at the balance date;
- failure to adequately consider the appropriateness of the calculation and recording of procurement and management fee revenue;
- failure to obtain sufficient appropriate audit evidence in connection with cash flow forecasts

and carrying value and classification of receivables, being audit evidence on which the going concern assumption was based;

- failure to consider the importance of the effect of continued fund raising through promissory notes subsequent to balance date and up to date of signing of the audit report that were in excess of the amount specified in the relevant information memoranda;
- failure to obtain sufficient appropriate audit evidence in connection with: actual costs to date and estimated cost to complete, revenue and profit of development projects being undertaken;
- failure to obtain sufficient appropriate audit evidence in connection with valuation and disclosure of receivables and disclosure of loans to and from related parties; and
- failure to qualify an audit opinion on the basis of inappropriate use of financial reporting and presentation standards applicable to non reporting entities in relation to non-compliance with financial reporting presentation and Australian Accounting Standards.

Mr Kelly

Mr Kelly signed unqualified audit opinions in connection with various entities within the Westpoint Group for the financial year ended 30 June 2004.

As a result of its investigations, ASIC formed a view that the audits of the entities conducted by Mr Kelly were inadequate and failed to comply with Australian Auditing Standards. ASIC's concerns in relation to the audits included:

- failure to obtain sufficient appropriate audit evidence in connection with cash flow forecasts and carrying value and classification of receivables, being audit evidence on which the going concern assumption was based;
- failure to consider the importance of the effect of continued fund raising through promissory notes subsequent to balance date and up to date of signing of the audit report that were in excess of the amount specified in the relevant information memoranda; and
- failure to obtain sufficient appropriate audit evidence in connection with actual costs to date and estimated cost to complete, revenue and profit with respect to a development project.

Mr Robinson

Mr Robinson was engaged by Westpoint Management Limited to audit compliance with the compliance plans of three managed investment schemes, for which it was the Responsible Entity, for the financial year ended 30 June 2004. Mr Robinson issued unqualified audit opinions in respect of the compliance plans for each of those schemes for that financial year.

ASIC's primary concerns in respect of the audits of the compliance plans, were that Mr Robinson failed to comply with Australian Auditing Standards and that Mr Robinson should have identified that there were material breaches of the compliance plans, and on that basis included an 'except for' opinion in the audit report. The most significant of the breaches contended by ASIC to be material were:

(a) late payment of distributions to members;

(b) late lodgement of financial statements and auditors' reports; and

(c) failure of the Compliance Officer to produce requested and necessary information to the Compliance Committee to enable issues of compliance to be properly considered.

Further, ASIC was concerned that there were a number of respects in which Mr Robinson failed to obtain

sufficient appropriate audit evidence of matters and failed to properly document his audit work.

BACKGROUND INFORMATION

The Westpoint Group collapsed in January 2006 with losses of more than $300 million.

The Group promoted investments in a number of property development projects, including 10 projects using unsecured mezzanine finance (a form of fund raising that covers the difference between available bank finance and the cost of the project).

It created mezzanine companies for each of these projects and raised funds for the projects through the issue of mezzanine investment products such as promissory notes.

The investors in Westpoint-related financial products had an outstanding total capital invested of $393 million when the Group collapsed. Liquidators and administrators of the various entities have estimated total amounts available for distribution to investors in respect of a limited number of the entities of $64 million.

ASIC has taken various steps to recover funds for the benefit of Westpoint investors.
https://westpoint.asic.gov.au/
Download the enforceable undertakings

Appendix "B" - Monitoring the Actions of the Manager

From colonialstate.com.au

3. Monitoring the actions of the Manager

City Pacific and the Fund are audited by external auditors through a 31 December review and a 30 June Financial audit as well as a Compliance audit each year.

Since 2005 City Pacific has contracted an external service provider (headed by an ex-ASIC senior investigator) to undertake a Compliance Officer role and monitor City Pacific's management of the Fund on a weekly basis and ensure it is compliant with clause 4.1 of the Fund's Constitution, the PDS, the Compliance Plan, Section 601FC of the Corporations Act and City Pacific's Australian Financial Service Licence.

Their findings are reported to the Compliance Committee, the Board and where necessary to ASIC.

City Pacific also communicates regularly with ASIC to ensure they are aware of the actions being taken to preserve the value of the Fund's assets and unit holders interests

Appendix "C" - Update on 'Pacific Beach' at Broadbeach

File summary
Supreme and District Court - Search civil files

7506/09 FORTRESS CREDIT CORPORATION (AUSTRALIA) II PTY LIMITED & others -V- FORESIGHT ACQUISITIONS PTY LIMITED — Supreme

Originated in	Currently in	File type	File nature	Date filed	Next listing
Brisbane	Brisbane	Originating Application	Caveat Removal	14/07/2009	(none) - (none)

Parties

Last/Company name	First name	ACN	Party role	Representative
CITY PACIFIC FIRST MORTGAGE FUND		088139477	Applicant	BAKER & MACKENZIE
CITY PACIFIC FIRST MORTGAGE FUND		088139477	Applicant	HOPGOOD GANIM LAWYERS
CITY PACIFIC LIMITED		079453955	Applicant	BAKER & MACKENZIE
CITY PACIFIC LIMITED		079453955	Applicant	HOPGOOD GANIM LAWYERS
FORESIGHT ACQUISITIONS PTY LIMITED		113407480	Respondent	TUCKER & COWEN SOLICITORS
FORTRESS CREDIT CORPORATION (AUSTRALIA) II PTY LIMITED		114624958	Applicant	BAKER & MACKENZIE
FORTRESS CREDIT CORPORATION (AUSTRALIA) II PTY LIMITED		114624958	Applicant	HOPGOOD GANIM LAWYERS

Events

Date	Event group	Event type	Chambers type	Resource	Result
22/07/2009	Applications	Application	Removal of Caveat	Byrne SJA	Order
17/08/2009	Trial	Hearing			

Documents

Doc. no.	Date filed	Document type	Document description	Filed on behalf of	Pages

SECOND SUPPLEMENTARY SUBMISSION – 2009 REVIEW OF MANAGED FUNDS

1	14/07/2009	Application (Originating)		Applicant
2	14/07/2009	Affidavit	OF G F HARGRAVES + EXH 1	Applicant
3	16/07/2009	Affidavit	OF G F HARGRAVES & EXH GFH-2	Applicant
4	20/07/2009	Notice of Address for Service		Respondent
5	27/07/2009	Affidavit	S MCCORMICK & EXHS SM10SM2	Applicant
6	22/07/2009	Affidavit	OF G A Perry - exh "CAP-1"	Respondent
7	22/07/2009	Affidavit	OF G A Perry - exh "CAP-1"-"CAP-3	Respondent
8	22/07/2009	Affidavit	Of G F Hargraves - exh "GFH-3"-"GFH-6"	Applicant
9	22/07/2009	Affidavit	OF C A Perry	Respondent
10	22/07/2009	Affidavit	OF S McCormick - exh "SM-1"-SM-2"	Applicant
11	22/07/2009	Outline of Submissions		Applicant
12	22/07/2009	Outline of Submissions		Respondent
13	10/08/2009	Notice of Change of Solicitors	RESPONDENT	Respondent
14	14/08/2009	Affidavit	OF P J SMITH PJS-1	Respondent
15	14/08/2009	Affidavit	OF C A PERRY & EXH CP-1	Respondent

Appendix "D" - The MFS PIF Experience

{please note, I have emphasised certain text that has commonality with the experiences of investors in the FMF – re: Fund Structure, Related Party Loans, Mezzanine Lending by Related Parties, Fortress, the holding off of declaring impairments, and debt}

Michael's Elysian Fields Fit for a king

By TIM HUNTER and ROB STOCK - Sunday Star Times

Last updated 05:00 23/08/2009

Michael King's equestrian estate, Elysian Fields, in the Gold Coast Hinterland. - Photo: Glenn Hunt

Michael King, the chief executive of MFS.- Photo: Michelle Mossop

Relevant offers

Elysian Fields, the Gold Coast estate of MFS founder Michael King, had a clubhouse for its polo-playing

owner "decked out like something out of Arabia", according to one visitor.

The $A20m property, inland from Surfer's Paradise, was a highly tangible status symbol for King, whose stated ambition was to run one of the top 50 companies in Australia.

For a while, he looked like making it. His business had a market capitalisation of $A2.2 billion in 2007. Now, not even the company's name remains and its remnants gather under the moniker Octaviar.

For New Zealand victims of his hubris the cost has been huge when the whole sorry enterprise collapsed last year the New Zealand company, MFS Pacific Finance, owed investors $454 million. So far secured debenture holders have got back just $57m and the prospect of further recoveries is receding into the distance.

It's New Zealand's biggest finance company failure after Hanover Finance and Bridgecorp, but hugely more complex. This month, after a court ruling in Australia on July 31, the shaky moratorium agreement voted in by Kiwi investors last May looks certain to be replaced by receivership or liquidation.

Financially this is not good news for investors, but there is a silver lining liquidators may finally untangle the web of related party deals and accounting trickery to reveal what, and who, wrought such billion-dollar devastation.

The business began modestly enough. King and business partner Philip Adams were lawyers at McLaughlins Solicitors on the Gold Coast where they established a small funds management business called McLaughlins Financial Services, later spinning the business out of the law firm and acquiring several property management rights, including that of the then-listed MFS Leverage Investment and Securities Trust in 2001. In January 2005, they merged the trust with the funds management business to create MFS Ltd. Thereafter they made a string of acquisitions, including accommodation businesses BreakFree and S8 that were to become the foundation of travel business Stella.

How MFS made money was a mystery to many people, but make money it did. An analyst with ABN Amro Morgans, Belinda Moore, said in 2007: "They are high-calibre people who always exceed their promises. So we are very confident about them."

A former chief executive of S8, Chris Scott, admitted to business magazine BRW: "At first I did not understand MFS so I didn't want to be involved with it. But as I listened to their story and it became more transparent to me, I became more understanding and more comfortable with them."

The business model appeared similar to that of Macquarie Bank in its focus on being a manager of other people's money, creating a range of investment funds from which it extracted fees. What some observers struggled with, however, was the extent of related party dealing which made it hard to keep track of assets and liabilities as they were shuffled around the group.

This was a major factor in the demise of its New Zealand arm, MFS Pacific Finance, and its related financial advisory firm, Vestar.

Pacific Finance was born from a much smaller finance company taken over in 2003 by MFS, which was keen to expand into New Zealand after stunning growth in Australia. In December 2006 MFS added Vestar, acquired from its Ferrari-driving founder Kelvin Sims, which was already selling debentures from Pacific Finance.

The idea was simple Vestar would channel investor cash into Pacific Finance, which would pass it on to MFS in Australia for use in lending to property developments in Queensland and New South Wales. A 2007 prospectus showed loans of $109m in NSW, $94m in Queensland and $22m in Auckland. Tens of millions of dollars of these loans were bought from, or sold to, other parts of the MFS group. The company also fed money into other MFS channels $22m, for example, was invested in units of funds managed by MFS.

Disclosure of related party transactions, the heart of the financial alchemy in MFS, took up nine pages of the document.

In July 2006 MFS agreed a "put option" deal with Pacific Finance whereby the New Zealand company would have the right to sell any loans more than three months overdue back to the Australian company at face value. The deal also covered investments such as the funds units if the market value fell below the price Pacific Finance had paid.

This arrangement formed a big part of the sales pitch to attract investors to Pacific Finance, who understood

that its financial future was literally guaranteed by its huge Australian parent, a guarantee that came at a cost of millions each year.

Pacific Finance boasted: "Notwithstanding the protection provided by the company's prudent lending and investing practices," it had "transferred all credit risk" to its parent by way of the put option agreement.

That sounded great to investors, who, perhaps encouraged by the presence of economist Donal Curtin on Vestar's investment committee, were accepting interest of 9.5% for a 12-month term deposit as it turned out, a paltry return given the risk compared to the 8.5% they could have been drawing from AAA-rated Rabobank.

What wasn't in the sales pitch, however, was that the put option allowed MFS to turn bad loans into good, as if by magic, by transferring them to Pacific Finance.

As at September 2007, Pacific Finance recorded loans of $37m more than two years overdue, but still classed as not impaired because they were covered by the put option. The bulk of these loans were acquired at face value in the previous six months from related parties in Australia.

This was bad enough, but when the MFS group collapsed under the weight of its debts in January 2008, it was the tip of the iceberg.

Not only was MFS effectively guaranteeing Pacific Finance through the put option, it was also publicly committed to providing cash flow to support the finance company's repayments to investors commitments of up to $27m, $32m and $22m, in January, February and March.

But MFS didn't have the money it was also due to repay corporate financier Fortress $189m in February, and was trying to raise money from a float of travel group Stella. On January 18 the Australian sharemarket suddenly realised MFS was much more heavily in debt than was previously thought and the share price went into free-fall.

Interest due to Pacific Finance investors on January 31 went unpaid and MFS, it rapidly became clear, was in no position to make good on the promises it had so expensively sold to Pacific Finance.

By the time investors were ready to vote on a moratorium deal offering an early repayment of $23m, they knew there was a massive black hole in the finance company's loan book. Of $476m of loans and investments, just $122.8m looked recoverable, they were told.

Although directors Jason Maywald and David Anderson signed financial statements in December saying 27% of loans by value had security of a first mortgage over real property, moratorium documents revealed the real picture was just 13%.

Maywald, who joined the firm in December 2006, has not spoken publicly about what happened, other than in veiled terms.

He told the Sunday Star-Times in May last year that there had been some "issues in the origination of the loan book at Octaviar" and "it appears some loans haven't got the position we would have liked".

As it transpired, a common practice was for Pacific Finance to provide top-up mezzanine finance to a property development, taking a second mortgage behind the first lender, a related Australian MFS fund called the Premium Income Fund which had about 10,000 investors.

All their lending was managed centrally by MFS in Australia.

To complete the circle, Premium Income Fund also lent huge sums on an unsecured basis to Pacific Finance, a portion of which funded debenture redemptions for Kiwi investors.

Such tangled relationships mean MFS-related companies have a Gordian Knot of claims against each other and the parent company, further complicated by the claims of third parties such as Fortress.

When the original moratorium deal was voted in last May, it looked like all those parties would agree on an orderly disposal of remaining assets, but hopes of a orderly wind-up have been dashed by court action from one creditor, the Queensland Public Trustee.

It was this that led to a court ruling on July 31 forcing Octaviar into liquidation and triggering an "event of review" in the moratorium deal. Other lawsuits are in train, including a class action against the Premium Income Fund's auditor, KPMG, alleging the fund's loans to Pacific Finance were illegal under related party rules in the Corporations Act and KPMG failed to alert regulators to this fact.

For Pacific Finance investors, there are only two routes to further recoveries. One is enforcement of the put option against Octaviar, the other is a damages claim against Octaviar Administration alleging negligence and mismanagement of the loan book. Both claims are for $461m.

Louise Edwards, CEO of Pacific Finance's trustee Perpetual, says she has asked Maywald, now based in Australia, for further information before deciding whether to appoint a liquidator to the Kiwi company.

"It's a complicated matter," she told the Star-Times last week. "It's not something we want to rush into."

Meanwhile, precious little is left in the Octaviar kitty to fight over. One of its biggest assets listed in December by then-administrator Deloitte was a 35% stake in Stella valued at $A128m. It was sold a few weeks ago for just $A3.5m.

As for King, he still has Elysian Fields, although according to one media report in Australia, its holding company, Canungra Property, is subject to a charge held by a New Zealand firm Pacific Finance.