

**Senate Select Committee on
Superannuation and Financial Services**

**Main Inquiry
Reference (a)**

Submission No. 107

**Submittor: Saxby Bridge Financial Planning
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SYDNEY NSW 2000
Mr Phillip Dally
General Manager**

Submission to Senate Select Committee On Superannuation and Financial Services

(Case Study of Commercial Nominees of Australia Limited (CNAL))

**by Phillip Dally
General Manager
Saxby Bridge Financial Planning Pty Ltd**

Firstly, Saxby Bridge wishes to make it clear that it has no ownership in Commercial Nominees of Australia Ltd despite references in Press Articles to the contrary.

Since 1998, Saxby Bridge has had a business relationship with Commercial Nominees of Australia Ltd when two of its services were outsourced to CNAL or its subsidiaries.

These services were –

1. Use of CNAL, as an APRA approved Trustee, to manage funds invested by small “DIY” superannuation funds, and
2. Use of CNAL to act as Trustee, Administrator and Manager of the Confidens Investment Trust (“CIT”), a vehicle that provided an internally geared Master Trust that allowed clients to gear investments without the need to apply for a separate Margin Lending Facility. The Confidens Investment Trust is owned by Confidens Asset Management, in which Saxby Bridge is a 50% owner. A company unrelated to both SXB and CNAL, HIGH MEADOWS PTY LTD owns the other 50%.

Saxby Bridge has acted in the best interests of its clients at all times. It made a decision to recommend that clients who required a “DIY” super fund use an APRA approved and regulated Trustee in order to assist clients with the significant responsibilities imposed on Trustees by current legislation. In particular we were concerned about the impact of the Superannuation Industry Supervision Amendment Act No 3 and the transfer of Supervision of Self Managed Super Funds to the ATO.

Our concerns lay not in the change of regulator itself, rather that a large number of people who see it as appropriate to establish their own Superannuation Fund do so naive as to their responsibilities, liabilities and duties that are required when they accept the role of Trustee of their own fund. This naivety may cause them to breach regulations that may have severe consequences on their ability to fund their own retirement.

This potential risk has been increased with the passing of the Financial Sector Legislation Amendment Bill (No.1) 2000, which introduces a strict liability on Trustees for breaches of Trustee responsibilities.

Why Commercial Nominees of Australia Ltd?

The market for this type of combined service is limited and at the time the service being provided by CNAL and its administration arm Fund Administrators of Australia (FAA) was seen by Saxby Bridge as offering an appropriate level of service at a reasonable price

Saxby Bridge is one of many companies that used the Trustee and Administrative services provided by CNAL. The list of companies that used the services of Commercial Nominees and its associated company Strategic Superannuation Solutions included:

INVESCO
AMP
ANZ
Royal Sun Alliance
State Street

The Directors of the CNAL included:

Mr Andrew Skinner, former national technical manager for ASGARD, a senior tax manager for Price Waterhouse, and an appointee on a number of committees of the ATO, ASFA, Univ of NSW and the Taxation Institute of Australia.

Ms Erica Robinson, former partner Corrs Chambers Westgarth specialising in Trustee Services and Superannuation.

Auditors were Arthur Andersons

They provided evidence of Professional Indemnity Insurance through HIH for \$20,000,000 for any one claim.

Saxby Bridge were also very much comforted by the fact that they were an "Approved Trustee", supervised by and subject to "the greatest regulatory scrutiny" by the Australian Prudential Regulation Authority.

When did Saxby Bridge start to see problems emerging within CNAL?

Until early 2000 we had had no real problems with the service levels and support provided by CNAL. Our first concerns were raised when the completion of quarterly statements for funds were considerably later than we would normally expect. The reason given by CNAL was that they had taken on a new block of business from the Sydney based Dealer Group, Charterbridge and they were working on upgrading systems to ensure satisfactory service and reporting levels could be restored. They made a number of new Staff appointments and engaged a new systems consultant to ensure that occurred.

As the year 2000 progressed, service levels failed to improve and we started to look for alternate service providers.

Part of the service offering was the use of a centrally controlled "enhanced cash management trust" that was used by CNAL to hold cash and process all transactions for the majority of the Small APRA Regulated Funds for which they acted as Trustee.

The enhancement to the cash management trust was the funding of loans to the Confidens Investment Trust (CIT).

The Confidens Investment Trust borrowed money from the ECMT and in turn the ECMT had a line of credit secured by CNAL from Colonial State Bank. If there was enough cash in the ECMT to meet the borrowing requirements of the CIT, no money would be drawn down from the Colonial State Bank facility, rather the interest rate that would have been paid to Colonial State Bank was to be paid to the investors in the ECMT. If additional liquidity was required CNAL could immediately draw down on the Colonial Facility to the total extent of the loan to the CIT. Other than this enhancement to return, all funds to our knowledge were held with Colonial State Bank.

The CIT also started to suffer from declining service standards and we started a process in late 2000 to advise clients to redeem from the CIT as it needed significant structural change to meet new requirements under the Managed Investments Act and we had lost faith in the ability of CNAL to administer the Trust going forward or their capacity to adequately address the changes required by legislation.

In September 2000, Saxby Bridge became aware that there may be a liquidity problem within the ECMT. This disclosure was made by the Directors of CNAL after Saxby Bridge was provided with information from a third party and I requested an explanation of an apparent liquidity issue.

Roger Meikle, then Managing Director of CNAL, subsequently came to Saxby Bridge offices on 6 September 2000 and outlined the following:

- a) The ECMT had approximately \$29 million in deposit funds of which three loans totalling approximately \$10.5 million had been loaned to:
 - o Peel Valley Unit Trust
 - o Midway Gardens Partners
 - o Equity Enhanced Fund
- b) APRA had been notified in March of the position and that the ECMT had a significant liquidity shortfall.
- c) PriceWaterhouseCoopers had been appointed to investigate the dealings of the Trust as part of the APRA 257 notice. That all directors at the time of the transaction were no longer on the board. These directors were Anthony Hall, Andrew Skinner, Erica Robinson and Ross Honeyman.
- d) That Saxby Bridge Financial Planning or ABS Securities had not been notified as CNAL feared a spate of redemption may trigger a "run on the fund" and investors may lose capital because of the inability to liquidate all assets.
- e) That there may be some security shortfall.
- f) That CNAL had reasonable grounds to believe that over time, all investor interests would be met by a work out and or possible sale of the long term loan to another party.
- g) That once the PWC report was completed, CNAL would restructure the trust into 2 parts:
 - 1) a longer term high yield vehicle and
 - 2) shorter term fund or transfer the cash to another CMT such as that operated by Macquarie
- h) That all new deposits into the fund since 1 April 2000 were placed in a notional second pool and therefore effectively quarantined out of the ECMT and any issues that may arise from the PWC investigation.

In the meantime, small redemptions would be actioned but larger redemptions withheld from those funds where the initial deposits were made prior to the establishment of the second notional pool.

Another meeting was arranged with Roger Meikle for 28 September 2000.

At the meeting were:

Roger Meikle, CEO, CNAL

Carl Hanich Director, CNAL

Maryse McMurdo Company Secretary, CNAL

Anthony Karam, General Counsel, Saxby Bridge Pty Ltd

Phil Dally, General Manager Financial Planning, Saxby Bridge Financial Planning Pty Ltd

At this meeting Roger explained again the loans that had been made and very clearly stated that:

- Funds deposited post April 2000 were quarantined and treated as separate to ensure that no new monies would be caught in any freeze or re-valuation of assets, if that became necessary.
- Future tactic would be that if CNAL would not reach settlement on ECMT balances would take out post 30/3/2000 deposits and place in a new account outside ECMT effectively closing down the trust from active use.
- Are looking at establishing a new trustee relationship, as they believed the licence was at risk. Made a comment that APRA have blocked any changes.
- Current position was that they would from the pre March 2000 deposits, pay out; pensions; investment obligation (on going).

They would generally meet redemptions from pre April 2000 deposits up to \$30,000 but reserve the right to suspend larger amounts until a resolution is reached.

Roger Meikle and the rest of the board agreed to:

1. Write to clients advising of facts when PWC report was completed
2. Copy to SXBFP on correspondence to APRA/ASIC
3. Refer to primary adviser to send out potential difference in any advice received.

Offered to establish a “special case” relationship team to work through potential issues that may arise.

I asked why we were not notified in March of the potential problem or even of what assets were now in the ECMT and was told by Roger that they had made an arbitrary decision not to notify us so that any redemption did not precipitate a liquidity crisis.

The directors stand behind that decision as they felt they could manage the liquidity sufficiently until they came up with an appropriate longer-term strategy.

On Tuesday 24 October one of the directors of CNAL, Carl Hanich, resigned as a director because of his ongoing concerns about the operation of the company. Tim Backhouse, a chartered accountant and an associate of the company secretary and Director of CNAL’s major shareholder, Power Capital Ltd, was appointed on Wednesday 25th as a director of CNAL.

On Wednesday 25 October I met with Mr Ross Honeyman, a former director of CNAL and still an officer and shareholder of the company, Sherin Ibrahim, Marketing Manager CNAL and Steve Hanich, General Manager Trustee Services CNAL.

The meeting was to “reassure” us that CNAL/FAA were doing all it could do to improve their service standards.

I raised the following issues regarding the ECMT. I asked [REDACTED] to confirm he was a Director at the time of the loan transactions and was he party to the approval of the subject long-term loans of the ECMT. He confirmed he was. When asked what was the motivation for approving such illiquid asset purchases, he replied that he had "relied upon the expert opinion of the other directors at the time," and in hindsight, "failed to fulfil his duty as director."

I asked if he was associated with any of the parties to which loans were made. [REDACTED] reply was that he was associated with the Midway Gardens Partnership so therefore was a potential beneficiary of that decision. However, he felt that the loans were done on a commercial arms length basis. The intention was to replace that loan with a limited offer raising via an information memorandum but that was never done.

[REDACTED] also informed that the Trustee Company, CNAL, was operating within the required NTA required by APRA to retain Approved Superannuation Trustee status but that it was in a way that APRA believed was through a loophole in the legislation that APRA's intention was to close this loophole as soon as enabling legislation was prepared and passed by Parliament.

Following this meeting I called a meeting with Anthony Karam, Saxby Bridge General Counsel and we rang Maria Good at ASIC. We then forwarded a written report the next day.

I was advised by Peter Cain, a Director of CNAL, on Friday 27 October 2000, that following the receipt of a letter from the previous directors of CNAL, Andrew Skinner, Anthony Hall and Erica Robinson dated 26 October, and a meeting with Peter Hedge of PricewaterhouseCoopers, that the Board of CNAL had accepted that the Australian Workforce Eligible Rollover Fund ("AWERF") had agreed to meet all redemption requests as the loans were effectively to cover equity investments made on behalf of AWERF.

I attended another meeting held in a conference room at the offices of Phillip Fox (legal firm), to negotiate the purchase of Flinders Asset Management by a Saxby Bridge Company and Carl Hanich from CNAL. CNAL was represented at that meeting by Roger Mickle, Peter Cain and Maryse McMurdo.

During a break in that meeting, we discussed the ECMT and Roger, Peter and Maryse all agreed that they had decided that there was no longer a problem in the AWERF taking additional units to provide total liquidity.

Roger Meikle also expressed some concern that future directors may try to change that direction, as he and Peter Cain were under pressure to resign, as it may reduce the value of AWERF.

This may be relevant, as CNAL had been negotiating the sale of the Australian Workforce Eligible Rollover Fund (AWERF) Trustee and Administration rights to Beacon Funds Management. Beacon has an equitable charge over Power Capital Ltd, the major shareholder of CNAL. The Managing Director of Beacon is Mr Roger Auton.

Roger Auton was a director of CNAL for 2 periods – 10 March 2000 to 20 April 2000 and 8 September 1994 to 12 February 1998.

Later that day when the meeting with CNAL was to reconvene, Mr Meikle and Mr Cain did not return as between 12.00 noon and 4.00pm the Directors of CNAL had changed. CNAL were now represented by two new Directors, Mr Richard Rudenko and Mr Damien Turier.

The Freezing of the ECMT

On Tuesday 7th November at 2.45 pm we were notified by CNAL that the Directors had frozen the ECMT and intended to revalue the assets on Directors valuations. They also advised that they would write to inform all unit holders.

Saxby Bridge urgently convened a meeting with the new Directors at 6.00pm that day to see why they had taken the action to freeze the account. We were told that they were new Directors, uncertain of the full position so had acted, in their opinion, prudently to protect all parties concerned and that they would fully advise on the outcome of a more complete inquiry and valuation.

Following the freeze Saxby Bridge held meetings with various parties to try to determine what happened behind the scenes in CNAL and were provided with various documents and information from previous directors and others as to why and where some of the money that was purported to be in Cash had gone.

This activity is currently subject to investigation by APRA and ASIC.

I do believe however that the ECMT that has impacted on our clients in small APRA funds is potentially only the edge of a chain of inter-related and non-arms length investments within the Group. It is possible that the ECMT was the last pool of money available to cover losses made over a long period of time through inappropriate investments made by the Trustee in its many capacities as Trustee over a number of funds where they had discretionary investment powers. These funds would include AWERF, Network and Miden

We are still surprised that the audit of the ECMT done by the accounting firm Arthur Andersons did detect the nature of the loans and the non-arms length loans particularly those to Directors of the CNAL. We understand that all loans were substantially in place prior to the Arthur Anderson's Audit of June 1999 and yet in June 2000 they could not form a view as to the value of the fund.

Further it would appear that the Trust was not run as a trust, rather a "pooled bank account" and that the records kept were less than satisfactory. Surely that is something that an Auditor charged with the responsibility to audit what is other people's money would need to consider.

Activity of the Regulators

ASIC

During our discussions with various parties we were advised by another Sydney based Dealer group, Charterbridge, that they had had concerns about some of the investments made in Trusts controlled by CNAL or Directors of CNAL and its associated company Strategic Superannuation Solutions. They were so concerned that in February 2000 they sent in an investigating accountant to look at these issues.

The Accountant was so concerned by what he found that he submitted a report to the MD of Charterbridge and insisted that the report be taken to ASIC. I have been told by the author of that report that he personally delivered the report to ASIC.

It was confirmed to me by Earl Burgess of APRA that ASIC had shared that report with them. I was further told that it was an "interesting read" but provided "no evidentiary proof" of any wrongdoing and that the regulators could not act without such proof.

In discussions on this point with the author of the report he stated that "there was no evidentiary proof as stated, but that with the investigatory powers possessed by ASIC and with the report as signposts where to look he believed ASIC could have found the proof required".

To my knowledge no investigation was launched into these issues and others that may have been related, until after the ECMT had been frozen and investors notified of potential losses.

Further we are concerned with the time delay in getting a new Trustee appointed to the ECMT. Time delays can often make it difficult to reconstruct events and we were hopeful a new Trustee would have been in place in early January 2001 and the appointment of Ferrier Hodgson did not occur until mid February 2001.

Saxby Bridge has provided copies of documents in our possession to ASIC.

APRA

We now know that APRA had been formally investigating the impaired assets of the ECMT and the Enhanced Equity Fund (EEF) since March – April 2000.

From previous evidence given by APRA to this committee they had concerns about activities within the CNAL group since early 1999. All of this concern and information was not available to either the public or the Industry.

We would raise the question that as from 1 April 2000 APRA had an ongoing investigation in place looking at assets that were impaired, why did they, or their nominee Peter Hedge, allow CNAL continue to place more funds into that particular fund? And why did it take so long for a full report to be completed? My understanding is that it took at least 6 if not 7 months before that report was completed.

APRA's once the scope of the problem became known should also be questioned.

From October - November 2000 Saxby Bridge had been looking at alternate providers to take over the roles of both Trustee and Administrators. We had a number of discussions, in particular with Perpetual Trustees, to work through an appropriate change that would not disadvantage the members of the funds or their investments.

Jointly, Perpetual Trustees, Australian Superannuation Nominees, CNAL and Saxby Bridge had met to plan a smooth transition. This was to include the completion of Audits, APRA returns and a complete reconciliation of the records with CNAL staff, where necessary with the assistance from the other Trustee Companies.

We were starting to build a timetable of movement when we became aware that APRA had issued a notice to show due cause why CNAL should retain its Approved Trustee Status.

On the 6th February I spoke with Earl Burgess of APRA's Sydney office and asked if it was likely that CNAL would have the status revoked and he replied that he could not answer that question.

I asked that if they were to consider such action what would they do in terms of appointing another Trustee to the Small APRA Funds as we had heard that they may be considering appointing a specialist approved trustee for example a firm such as Sims Lockwood.

Our interest lay in ensuring that a change of Trustee was appropriate and would not disadvantage clients and would APRA take into consideration that if fund members wanted to appoint a Trustee such as Perpetual would APRA allow that to occur?

Earl declined to answer again but said that hypothetically that if APRA did in fact use its power under SIS it would need to call for Tenders for that role and that companies like Perpetual may be invited to Tender.

The successful tenderer would need to demonstrate that it had the "expertise, knowledge and systems" to carry out the task and importantly were in a position to act quickly.

The process had to be totally open and transparent so that APRA could not be accused of treating any one trustee more favourably than another.

He further advised he could not advise of the time frame in which APRA were likely to make a decision. I asked within a month. His answer was, "no comment".

The next action was on the 13th February (only 6 days later) they appointed Oakbreeze Pty Ltd, a company of PriceWaterhouseCoopers as the specialist approved Trustee.

The directors of that company are Peter Williamson and Peter Hedge. Peter Hedge was also the Investigator that did the initial investigation on the impaired assets in CNAL. Saxby Bridge are concerned that there may be some conflict of interest that could arise from this dual role

On their appointment little happened other than a direction to FAA to stop all transactions and both Directors then proceeded on overseas holiday for almost two weeks.

I rang APRA (Earl Burgess) to seek direction as it came to our attention that this stopped Pension payments and payments of Life Insurance Policies within the Funds. Mr Burgess response was that "Oakbreeze was the Trustee, they knew their responsibilities and APRA could not advise them what to do". A meeting was held after I spoke to Mr William Honner from Oakbreeze who did arrange urgent payments other than any Payments to members such as Pension Payments.

As Oakbreeze had no staff, no systems and no resources to handle the funds FAA was asked initially to continue to work as administrators so life did not stop completely for the funds.

To further delay the process on the return of the Directors from leave they decided that they would do all administration in house and 3 weeks ago removed all records and computers from CNAL

offices and took them to PWC offices. They then started to recruit staff by first offering roles to ex CNAL staff. As at a week ago they had two staff from CNAL.

To this date NO pension payments have been paid and they have not advised myself, despite requests on behalf of Fund members, when they may be in a position to commence pension payments again. Arrangements had been finalise under the previous Trustee to recommence some Allocated Pension Payments once liquidity had been restored by the sale of un-impaired assets.

This is now causing considerable distress to the members so effected, who some have had to go some 6 months without Pension Payments. I have attached a summary from one of our adviser's clients [REDACTED]

Other clients such as Jill & Jeff Shepherd in Brisbane are now asking if they have to sell the kitchen furniture to afford food as their non super cash reserves are no running dry having received their last income payment in October 2000.

Our concern is that the current Specialist Approved Trustee did not have the "expertise, knowledge and systems" to carry out the task and importantly were NOT in a position to act quickly and appropriately to not cause further distress delay and cost to the effected funds. Some 6 weeks after their appointment by APRA they cannot answer the most basic queries.

Fund members have not been advised of the costs of this interim administration and my enquiries have been met with the answer "We are mindful of the costs and currently seeking advice as to how much we can pass through to the fund members".

It is my opinion the Approved Specialist Trustee was not appropriately chosen and is acting in the capacity of a receiver rather than as a Trustee of a Superannuation Fund acting fully in the beneficiaries best interest because they are not experienced as Fund Trustees and did not have the systems to cope. Rather their experience is as a receiver.

FUTURE

It is apparent to us that the regulatory supervision of the APRA approved and regulated Trustee Commercial Nominees of Australia failed to detect what now appear to have been long term systemic problems within the company for a long time.

APRA officers have commented to me that in their opinion they do not have the power that they require to act in a way that may protect investors from this type of activity occurring

As the SIS act is currently regulated by APRA, ASIC & ATO there is always the opportunity for one to expect that the other regulatory body is responsible for a particular issue so it is not "our" responsibility.

This was apparent in this case with APRA saying they are responsible for Superannuation, ASIC is the one responsible for Trusts. Therefore how do you logically proceed where a Super fund invests in a Trust? Particularly relevant where potentially the ECMT is an "unregulated" trust.

The industry has a right to be concerned that because of the dramatic failure of the supervision system that allowed such problems to go undetected and when detected nothing happened till failure

occurred that there may be a regulatory over reaction that may cost the industry and therefore all users of the system more.

I believe that the constant change in Superannuation rules and regulations over the past 18 years has created mistrust in a system in the minds of Australian citizens and the Government can ill afford further mistrust through dramatic failures such as CNAL.

Section 229 allows for the Government through APRA to compensate funds where the Trustee has acted fraudulently or inappropriately. I believe prima facie evidence of this exists for the Government to consider such compensation. To leave the recovery actions to a normal commercial process will take excessive time, particularly with the complicated issues involved, will be expensive and may leave affected Superannuants uncertain as to their future for years. APRA could retain the rights to action against the various parties concerned and in the end could be revenue neutral for the Government.

Phillip Dally
General Manager
Saxby Bridge Financial Planning Pty Ltd

Attachments;

Letter from General Manager CNAL Trustee Services
Letter from previous Directors of CNAL

15 December 2000

Stephen Hanich
17 Polding Road
Lindfield NSW 2070
Phone: 9416 1491

Mr Phillip Dally
General Manager
Saxby Bridge
Level 6, 4 O'Connell Street
Sydney NSW 2000

Dear Phillip

Enhanced Cash Management Trust (ECMT)

I was an employee of Commercial Nominees of Australia Limited (CNA) from 2 June 2000 until 1 December 2000. During this time, I held the position of General Manager reporting directly to Roger Meikle, Chief Executive Officer of CNA.

Within the first weeks of my employment, I was advised that the ECMT had a liquidity issue and that, as Trustee of this fund, CNA needed to determine a formal redemption policy. This was formulated between Roger Meikle and myself, however, I cannot confirm whether this was ratified by the CNA Board.

Nevertheless, this policy was adopted and applied to day-to-day redemptions from the ECMT. The main thrust of the policy encompassed the following:

1. A notional second Pool was determined within the ECMT for all monies received after 31 March 2000. Monies received prior to 1 April 2000 represented the first (or original) Pool.
2. Any redemptions requested in respect of monies within the second Pool were to be paid unprohibited. That is, any monies received after 31 March 2000 would not be caught up in the liquidity problems of the ECMT. This philosophy was in lieu of actually closing the ECMT to new monies and opening a completely separate account (however, in practice it would act exactly the same).
3. All pensions were to be paid irrespective of which Pool the monies were in.
4. Redemptions from the first Pool were treated on a case-by-case basis dependent on the size and purpose of the redemption.

I use the word "notional" second Pool, as no physical second Pool was established. Each redemption request was accompanied with a transaction listing from the ECMT to allow CNA to determine whether the redemption represented monies deposited before or after 1 April 2000.

At this time, I did not have any knowledge of the underlying assets of the ECMT. I was advised by Roger Meikle that some of the assets were in the form of Loans and that these were causing liquidity problems for the ECMT.

I did not have any cause to believe that any of the Loans were unrecoverable. I further believe that Roger Meikle did not believe the Loans to be unrecoverable. It was quite clearly communicated to me that we needed to manage through the redemptions (by way of our Redemption Policy) until such time as the Loans were fully repaid. There was never a discussion suggesting that any of the Loans might not be repaid.

Given this, and the fact that all new monies were distinct from any of these liquidity issues, CNA did not send out any general correspondence to members and financial advisors advising them of the ECMT.

We believed that this was a relatively short-term issue and that notification to all parties concerned would only have resulted in a panic within the industry.

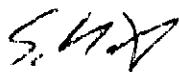
I can confirm a telephone conversation I had with you in early September, when you first became aware of the ECMT's liquidity. You had, at that time, been made aware of this through Paul Hudson, a financial advisor with about six superannuation clients whose rollovers out of the ECMT had been temporarily suspended. You then immediately rang me to determine what was going on.

Following this telephone conversation, I organised a meeting between yourself, myself and Roger Meikle to discuss the issues. At this meeting, Roger divulged to you the underlying assets of the fund and also his view on the situation.

Furthermore, at this meeting, Roger confirmed to you that all new monies received after 31 March 2000 were fully liquid. This was also my firm belief, and something which I probably confirmed to yourself and other Saxby advisors from time to time.

This policy remained consistent until the wholesale Board change in early November when the new Board determined to suspend all transactions within the ECMT.

Yours sincerely



Stephen Hanich

26 October 2000

The Directors
Commercial Nominees of Australia Limited
Level 1, 140 Sussex Street
SYDNEY NSW 2000

Attention: Mr Peter Cain

Dear Sirs

**Commercial Nominees of Australia ATF
Enhanced Cash Management Trust ("ECMT")**

Introduction

We refer to the above and our various discussions in relation to certain loans from the ECMT.

The purpose of this letter is to summarise our discussions and to confirm the basis on which the directors of Commercial Nominees made the loans from the ECMT.

This letter has been signed by Andrew Skinner, Erica Robinson and Anthony Hall. Mr Ross Honeyman is aware of the content of the letter, however, he has not been contactable over recent days; not returning various messages left on answering machines.

We understand though that Power Capital, a company Mr Honeyman is associated with has agreed to sell its sponsorship and administration rights to the AWERF to Beacon Funds Management for \$2 million. The sale of the sponsorship rights to Beacon Funds Management will result in an earlier loan provided by Beacon Funds Management to Power Capital being netted off against the sale proceeds.

Mr Honeyman was a guarantor of the earlier loan. As a result, the sale of the AWERF to Beacon Funds Management is in the interests of Mr Honeyman. Any commitment by AWERF to the ECMT may jeopardise the sale.

We have two people, independent of the directors of Commercial Nominees at the time, prepared to attest to the general content of this letter.

Loans

For the sake of clarity we are referring to the following loans that happened throughout late 1998 and 1999:

1. Peel Valley Unit Trust ("PVUT") @ bills plus 2.5% per annum;
2. Midway Gardens Partners ("MGP") @ 9.5% per annum; and
3. Equity Enhanced Fund ("EEF") @ bills plus 2.5% per annum.

Understanding of Directors for Basis of Loans

The above loans were made over a period of time by the directors having due regard to the relevant circumstances at the time of making each loan. Such circumstances included various inter-connected vehicles of which Commercial Nominees acted as trustee.

The loans were made on a commercial basis, however, the directors recognised that the loans were potentially not liquid given the nature of the loans. Accordingly the directors expected that if the ECMT had liquidity requirements that AWERF would be able to invest in the ECMT to satisfy any liquidity requirements. This was a reasonable expectation given the loans directly affected the value of investments indirectly held by AWERF.

As a result, there was the understanding of the directors that the AWERF would effectively "stand behind" the loans. The AWERF was to stand behind the loans by depositing funds in the ECMT to support its liquidity.

The directors viewed the arrangement as an implied underwriting agreement that was not dissimilar to an underwriting arrangement that the directors at the time in May 1997 agreed to with respect to the redeemable preference shares in Strategic Capital Investment Limited ("SCIL"). In this instance the directors agreed to provide up to \$3.25 million to SCIL from various superannuation funds for which they acted as trustee.

Rationale

All three loans were made to support the Equity Enhanced Fund ("EEF") with respect to various investments it held. Importantly the AWERF owned approximately 70% of the units in the EEF. These units were held in the Pooled Division of the AWERF.

The Pooled Division at the time had a considerable investment in the Australia First Life PST which subsequently was rolled into the Beacon Capital Secure PST. The Australia First Life PST had received a windfall gain from the AMP demutualisation. This gain was being distributed to unit holders over a three year period and had also been used to bolster the reserves of the PST.

At the time, the investment in the PST was yielding approximately 18% per annum. Needless to say it was yielding approximately 10% more per annum than bills plus 2.5%. This equates to \$100,000 per annum for every million dollars.

At the time the EEF had three investments that were causing concern. These were the investments in Peel Valley Mushrooms Limited ("PVM"), the money on deposit with Bellcap Pty Limited ("Bellcap") that was contingent upon the performance of Queensland Essential Oils Limited, and Strategic Capital Investment Limited ("SCIL").

The loan to the PVUT aided the PVM and Bellcap investments:

- The loan to the PVUT provided PVM with a farm to continue to grow mushrooms.
- The directors had received a valuation from Colliers Jardine that placed a valuation on a similar farm at between \$15 and \$17 million.
- The mushroom farms were ultimately to be merged with two tomato farms and a stock market listing attempted.
- The directors of PVM were also associated with the two tomato farms and had agreed to exchange the money on deposit with Bellcap for money on deposit with ATF No.1 Pty Limited ("ATF") that was contingent upon the performance of Quality Food Productions Pty Limited, the manager of the two tomato farms.

Notwithstanding the fact that the loans provided PVM a farm and enabled the directors to exchange Bellcap for ATF, the two mushroom farms at full potential production were valued between \$15 and \$17 million. After the loan from the ECMT and the vendor finance there was still \$4 million of equity on a \$15 million valuation.

The loan to MGP supported the SCIL investment.

- SCIL had approximately 1.7 million shares in AHC Limited. The shares were trading at around 55 cents per share. On a fire sale, SCIL would have received between 30 and 40 cents per share.
- The MGP purchased the shares from SCIL for 88 cents per share.
- The MGP arrangement also involved a retirement village development that AHC was to build and manage. AHC believed it could return between 30 and 35% net to investors. This provided the investors the inducement to acquire AHC shares at 88 cents per share. In addition it sought to add value to AHC by providing it with profitable work.

The loan to EEF aided in the diversification of the EEF and the fulfillment of commitments.

AWERF

Another important consideration for the directors was the nature of the AWERF. The AWERF is an "eligible rollover fund" ("ERF"). An ERF is generally used by superannuation fund trustees to hold the money of lost members. By its very nature it is a long term investor.

In addition to the AWERF being a long term investor, the directors had also been embarking on a program of placing funds into reserves. The over performance that had been achieved through the investment in the Australia First Life PST was being used to bolster reserves.

The collective underwriting by the AWERF meant the directors did not have to redeem the AWERF's investment in the Beacon Capital Secure PST and lose out on the 18% per annum this fund was returning.

ECMT

At the time substantial cash was accumulating in the ECMT. This cash was returning bills minus 0.5% per annum. Lending this money to the PVUT and EEF meant the ECMT was able to get an additional 3% per annum. The money lent to MGP returned more than an additional 3% per annum given where interest rates were at the time.

The directors also capped the return of the ECMT to bills plus 0.5% per annum which meant that the ECMT was building up reserves. This was seen as a prudent course of action in the event something unforeseen occurred. In addition, unit holders in the ECMT were benefiting by receiving a return of bills plus 0.5% per annum which was 1% per annum greater than the comparable cash at bank rate.

The directors considered it reasonable at the time that funds in AWERF could, if necessary, be invested on a commercial basis in ECMT to satisfy liquidity needs arising from the illiquid nature of the loans made by ECMT described above.

Should you have any further queries about the above please do not hesitate to contact us.

Yours sincerely

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