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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL
SERVICES

Reference: Financial products and services in Australia

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**JOINT STATUTORY COMMITTEE
ON CORPORATIONS AND FINANCIAL SERVICES**

Thursday, 3 September 2009

Members: Mr Ripoll (*Chairman*), Senator Mason (*Deputy Chair*), Senators Boyce, Farrell, McLucas and Williams and Ms Grierson, Ms Owens, Mr Pearce and Mr Robert

Members in attendance: Senators Farrell, Mason, McLucas and Williams and Mr Pearce, Mr Ripoll and Mr Robert

Terms of reference for the inquiry:

To inquire into and report on:

Issues associated with recent financial product and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses, with particular reference to:

1. the role of financial advisers;
2. the general regulatory environment for these products and services;
3. the role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;
4. the role played by marketing and advertising campaigns;
5. the adequacy of licensing arrangements for those who sold the products and services;
6. the appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served;
7. consumer education and understanding of these financial products and services;
8. the adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and
9. the need for any legislative or regulatory change.

WITNESSES

ANDERSON, Mr Graham John, Secretary/Treasurer, Storm Investors Consumer Action Group.....	68
CASSIMATIS, Mr Emmanuel, Private capacity	1
FORSYTH, Mr Jolyon, President, Australian Investors Association.....	41
HANCOCK, Mr Benjamin William, Partner/Senior Adviser, Stonehouse Wealth Management	108
JELICH, Mr Radomir (Ron), Private capacity	90
KING, Ms Sharron, Private capacity.....	57
McARDLE, Mr Sean, Private capacity.....	101
McKENZIE, Mr Scott, Vice-President, Australian Investors Association.....	41
O'BRIEN, Mr Noel Terence, Co-Chairman, Storm Investors Consumer Action Group	68
WEIR, Mr Mark Robert, Co-Chairman, Storm Investors Consumer Action Group	68

Committee met at 9.02 am**CASSIMATIS, Mr Emmanuel, Private capacity**

CHAIRMAN (Mr Ripoll)—I declare open this public hearing of the Joint Parliamentary Committee on Corporations and Financial Services, part of a series of public hearings the committee will hold to inform its inquiry into financial products and services. The committee is inquiring into issues associated with recent financial product and service provider collapses such as those of Storm Financial Group, Opes Prime Group and others. In conducting its inquiry the committee has made a decision to focus specifically on non-superannuation products and services. Witnesses giving evidence to the committee are protected by parliamentary privilege. Any act which may disadvantage a witness on account of their evidence is a breach of privilege and may be treated by the parliament as a contempt. It is also a contempt to give false and misleading evidence to a committee.

Welcome. Is there anything you wish to add about the capacity in which you appear today?

Mr Cassimatis—I appear here as a former CEO and director of Storm Financial.

CHAIRMAN—Do you want to make an opening statement?

Mr Cassimatis—Yes, thank you. Firstly, I would like to apologise for Julie's absence. She is quite unwell. I am the founder of one of the companies which have led to this parliamentary inquiry, Storm Financial Group. Today I would like to outline my response to some of the committee's targeted issues and my thoughts on these issues in relation to Storm. Firstly, I would like to acknowledge that I strongly feel the downfall of Storm and the effects on everyone from the fallout. Whilst I believe it was not our doing, nevertheless it happened on our watch. The moral responsibility of that fact is overwhelming, and we feel its crushing effects and responsibility every day. I wish to repeat here today, as I did to Storm clients in October and November 2008, that I am deeply sorry for the position in which we all find ourselves. I now wish to extend this apology to include Storm staff, other suppliers to Storm and, in particular, CBA staff, with a special thought to those CBA staff who took part in no wrongdoing but who now find themselves the sacked scapegoats covering the backs of those further up the line.

The origins of the devastating collapse of Storm Financial Limited can be found in a landscape littered with unprecedented turmoil due to the worst economic crisis the world has seen since the Great Depression. Journalists and even some politicians seem even today to overlook the fact that 2008 saw an enormous and very rapid loss in value of investments on the financial and equity markets. The financial services industry as a whole is being affected by the Storm collapse. Regulators are scrambling to play catch-up and find a culprit to appease media and community pressure, banks are scrambling to distance themselves and politicians have called for and commenced a parliamentary inquiry. Industry bodies such as the FPA have stepped in and called for calm, and class actions have been touted by vocal litigation firm lawyers. The media gathers its headlines, again finding the ease of the superficial view most satisfying. In amongst it all, the clients of Storm Financial, whilst devastated, remain hopeful that someone will sort the mess out for them, Storm having nurtured their wealth building over a long time—some having been guided by Storm since the foundation of the firm in 1972.

As we understand, the committee's duties are to inquire into and report to both houses on (1) the activities of ASIC and the Takeovers Panel and (2) the operation of the corporations legislation. The committee may also inquire into a question in connection with those duties referred to it by parliament. Under the terms of reference the purpose of this inquiry is to inquire into the issues associated with, relevantly, the collapse of Storm Financial. This is presumably connected to the committee's duty to report to the parliament on whether existing laws need changing or new laws are required to prevent the many events precipitated by the global financial crisis from recurring if possible.

I believe that this parliament, which is the ultimate regulator and which inherited this crisis, is uniquely placed to either significantly alter the course of future events for the better or reset the same course towards a repetition not only of the events of 2007-08 but of the many similar events since and including the Great Depression. I ask the committee for a few moments indulgence to mention some rather fundamental matters. I assure you I will make them relevant to your terms of reference.

In my view, better laws and hence better outcomes can only be obtained if the fundamental root cause of the problem is addressed. A tinkering with existing laws, which will have the effect of maintaining the status quo and letting the excessive power remain where it has become concentrated, will not be helpful in my view. It is essential that this concentration of power be reallocated away from where it is in order to restore the balance and the checks required within the balance. This may be a difficult task.

The overarching problem is: where has this balance come adrift? Our nation's and our society's four cornerstones are: the people, with the democratic power to vote; the economy and business, which, through financial incentive, establishes and maintains commerce; government, which has a role of balancing commerce and redistributing wealth through mechanisms; and, of course, the free press. How does this relate to Storm? One of the principal causes of the global financial crisis and the destruction of world liquidity was subprime lending. The economic power acquired by the finance sector, particularly in the US, fostered that and other practices. Business and commerce have come to dominate the other three. In the preglobalised environment, each government was able to do battle, so to speak, with its own economy and vice versa.

When the four players were evenly matched, the battles more often came out even. However, economic globalisation, which is the integration of national economies into one international economy, has meant, in the absence of one international government, that each individual government must now counterbalance not only its own economic imperatives but the goliath international globalised economy. Clearly, the tail is now able to, and indeed does, wag the dog. In a world where there are political borders but no or few economic borders, the demigods of commerce, who are the gatekeepers of capital—that is, the world's bankers—are able to roam freely and exercise their power with impunity.

I observe, for example, that the practices of the banks were not—I repeat not—in the original terms of reference of this inquiry. I encourage you to consider why, in Australia and around the world, the very institutions who caused the subprime crisis and got themselves and the rest of us in such hot water are able to demand and get the tax-funded guarantees not only to keep them afloat and solvent but to enable them to push on to even higher profits.

A redistribution of power is needed between the four cornerstones. That, of course, is not mentioned in the terms of reference. But I submit that when considering ‘the issues associated with the recent collapse of Storm Financial’ and ‘the practices of banks and other financial institutions in relation to margin lending associated with Storm Financial’, you cannot avoid considering the power of the bank to affect the lives of its customers, its responsibility to act in accordance with its own terms and conditions in the margin lending agreements and its relationship with and influence over ASIC and the press.

To return to specific matters, despite the large amount of conjecture around the issue, the reason Storm collapsed, when you boil it down, was that the Commonwealth Bank—the major supplier of credit to Storm and its customers—withdrawed the credit suddenly, without notice and, most importantly, without justification or indeed without the power to do so under the margin lending contracts.

Despite the fact that the CBA caused a great deal of damage, it exercised its power simply because it could and chose to wreck rather than support Storm and our mutual clients as it had done in the past. The decision by Mr Norris and his colleagues at the Commonwealth Bank of Australia to withdraw credit was made with full knowledge of the devastating consequences such an action would cause. Without this action, the margin lender customers would undoubtedly have suffered some losses, but they would have retained at least some of their assets and would not be in the devastated financial condition that most are in today.

Suffice it to say that the global financial crisis hit smack bang in the middle of where Storm Financial lived. What started as a credit crisis led to a financial crisis which then led to an economic crisis. Despite the multiplier effect of this crisis, the directors of Storm firmly believe that its risk management strategies would have ensured that the company and clients would still have been standing, albeit somewhat battered and bruised, had the CBA issued its borrowers the margin calls as it had always done in the past. For some reason unknown to us, this protocol had been switched off. We know that each day the CBA system produces letters to be sent to customers. These letters were the bank’s notices of margin calls. We know that someone decided not to send these letters. However, there was one formal margin call letter that leaked through the system to one Storm client, indicating that the system worked.

Some testing I have done to date following the collapse of Storm on our reparticipation model had indicated to me that a great number of, if not all, clients would by now have been back to viable positions where their portfolios would continue to service their debt had two things happened: first, had the bank issued margin call notices to the clients; and, second, had it issued the notices at the right time.

We also now know that CBA’s data feeds to Storm, and hence its website on which the customers and Storm were supposed to be able to check their positions, were deeply and hopelessly flawed. Let me repeat that: CBA data feeds to Storm and hence its website on which the customers and Storm were supposed to be able to check their positions, were deeply and hopelessly flawed. The errors were not simply that they were a few days late because a few funds were suspended for a few days or because the markets were in turmoil; the data, we now know, was scrambled. This reinforces what I have been saying all along—that is, that the problem was not excessive debt or excessive gearing; the problem was that the CBA chose to

destroy the asset that services that debt. I might add that the disruption of Storm by the CBA has affected other banks, in that their loans also cannot be serviced.

Contrary to the belief that I have gone underground, I spend each day working to find a solution for everyone to the mess we all face. There have been other issues aired in the media. I cannot answer them all, but I do want to table some documents, if I may. I wish to be as helpful as possible. Thank you very much for your time.

CHAIRMAN—Mr Cassimatis, can you begin by perhaps explaining to the committee the role you played at Storm Financial and what that role involved?

Mr Cassimatis—I was the joint CEO and director and generally oversaw most of the strategic direction of the company.

CHAIRMAN—Can you explain a little bit further? There must have been a bit more than that in terms of your day-to-day operation. What I am trying to understand and get on the record is: what did you do at Storm? You were the CEO, but what did you do there?

Mr Cassimatis—That role changed as the years progressed. When it started many, many years ago—decades ago—I was the principal adviser, a one-man band, so to speak. By the end, that morphed into less and less advising and more and more strategic role setting.

CHAIRMAN—So you were not directly involved with clients as much as you were involved with the operation of the business?

Mr Cassimatis—That would be a fair statement.

CHAIRMAN—Was the operation of the business more focused on the development of the investment model or the strategic direction of the business? How would you describe that?

Mr Cassimatis—As a motor vehicle evolves from the Model-T Ford to today, both the business model and the investment model evolved as time went on, as everything does. So we were involved with both. Principally, the investment model was pretty much set, so the weight of what I was doing tended to move towards the strategic direction of the company.

CHAIRMAN—So you would say that you were—

Mr Cassimatis—In the roll-out, so to speak.

CHAIRMAN—Who would you say was the responsible person in terms of the strategic direction, strategic decision making and strategic evolution, as you describe it, of the model and the Storm Financial business?

Mr Cassimatis—We prided ourselves in having a very flat hierarchy rather than a chain, and each person who was able to contribute contributed. We had an executive and we would have meetings from time to time and different people would contribute. So it was quite flat. It was just about gathering—

CHAIRMAN—So there was a whole range of decision makers and people could make individual decisions?

Mr Cassimatis—Yes, there was.

CHAIRMAN—We have heard evidence from people who either worked for Storm or others that it was very much the opposite; that it was very much a hierarchical type structure where all the decision making was centralised and everything was filtered through one point. Some people described it as a financial advisory factory. How does that sit with what you are describing as a flat structure?

Mr Cassimatis—I do not think there is a conflict. It was a financial advisory factory. We had created a production mechanism and there were various cells responsible for various states of the production—and so it went. There was no one point that could dominate and make decisions about everything every day.

CHAIRMAN—You used the analogy of the Model-T Ford and that factory. There was something quite famous said about that: that you can have any colour you like as long as it is black. Is that the sort of factory—that you can have any advice you like as long as it is the same?

Mr Cassimatis—I would more see it akin to: you can have any vehicle you like, and it can be a car or a horse-drawn buggy. That evolved. The Model-T was black, but the current Falcons are all multicoloured.

CHAIRMAN—In trying to understand the role that financial advisers played in the Storm model, what could an adviser at Storm advise on and what recommendations could they make? For example, could they invest in cash and property or buy land? Was that typical of the advice?

Mr Cassimatis—They had the ability to make recommendations to the cash flow cells that were creating those plans as long as that was somehow justified by them—as long as they could justify what they were advising. However, we were quite a unique model, and the way we approached it was rather than be everything to all people, we went the other way and we said, ‘This is what we do. We are specialists in leveraging,’ and if 100 people walked through the door, statistically, 25 or one in four would proceed with our plans and three out of four would not. So we did specialise; we did not do everything for everybody.

CHAIRMAN—So there was not much scope to go outside? You said that advisers had the ability, but did they? Was that part of what you provided? It seems that you are describing something different. Maybe you can explain it to me.

Mr Cassimatis—I am not fully cognisant of the question.

CHAIRMAN—It appears that everybody got the same advice and, in the end, everyone was put into a particular fund, used a particular type of leverage and used a particular number of lending institutions. They all seemed to be using the same model. As you describe it, it all seemed to be very much like a factory but everyone had the same outcome in the end.

Mr Cassimatis—Yes, it was a unique offering—like a motor car. There was one particular model of vehicle.

CHAIRMAN—So it was unique, but—

Mr Cassimatis—Those who wanted that could buy it and those who did not—

CHAIRMAN—Sure.

Mr Cassimatis—A McDonalds would be a classic case: they are the burgers and, if you do not want it, there is elsewhere to go.

CHAIRMAN—So it was unique but different for everybody?

Mr Cassimatis—What was different was their circumstance; what was unique was the model.

CHAIRMAN—But you do acknowledge, though, that every individual circumstance was different or may have been different?

Mr Cassimatis—What I said was we went the other way and we presented our offerings and educated clients and three out of four did not participate and one in four did. It was about attracting those people who wanted to go that way as opposed to saying, ‘We have a shelf full of everything that you may want.’

CHAIRMAN—How would you describe the typical Storm investor?

Mr Cassimatis—A typical Storm investor would be the demographic that covers Australia, without exception.

CHAIRMAN—In terms of meeting your obligations, you the AFS license holder—the Australian Financial Services licence. Are you the principal holder of that licence for Storm Financial?

Mr Cassimatis—I was.

CHAIRMAN—Did you understand your obligations under the Corporations Act?

Mr Cassimatis—I believe so. I had a team that assisted in that as it got more complex.

CHAIRMAN—Did each individual adviser take responsibility or act in accordance with Corporations Law in terms of managing each portfolio, each client—the know your client principle; the appropriateness principles?

Mr Cassimatis—To the best of my knowledge, yes.

CHAIRMAN—And you would then say that the product that you provided, even though it was all the same product in the end—or class of product—was appropriate to all those people’s individual circumstances?

Mr Cassimatis—Yes. We took a prescriptive approach. We put people through an education process that lasted hours. I cannot remember the exact number of days, but it was something like 199 or 200 days for the average client to go from point A to becoming an investor—and I repeat: three out of four did not along the way. So, yes, I believe that to be the case.

CHAIRMAN—So you would describe then that, roughly, they were all individuals but, all the same, at the same time perhaps they were all very high-risk-taking investors—that these are people who take lots of risks?

Mr Cassimatis—No, not at all.

CHAIRMAN—No?

Mr Cassimatis—No.

CHAIRMAN—How would you describe, in terms of risk, placing somebody’s home as collateral in any portfolio exercise? Is it very low risk, low risk, medium risk, moderate or high? How much risk is there that they could lose their home at all, hypothetically speaking?

Mr Cassimatis—Under normal circumstances I would have described it as not much higher risk than your typical person who uses their home equity to buy another home or a holiday home or a set of investment units. It is only the asset class that was different; it was equities based rather than property based.

CHAIRMAN—How well did you understand your own model?

Mr Cassimatis—I believe fairly well.

CHAIRMAN—Do you think all your advisers understood your model fairly well.

Mr Cassimatis—I cannot answer to them. I would hope they did.

CHAIRMAN—You would need to be a bit more specific than ‘hope’. It is your obligation as the holder of the Australian Financial Services Licence that you are actually responsible for all your advisers.

Mr Cassimatis—Well, you educate people and you believe that they do.

CHAIRMAN—So you hope and believe that they do.

Mr Cassimatis—Yes.

CHAIRMAN—Was your model complex?

Mr Cassimatis—In principle, no; in execution, yes.

CHAIRMAN—Was it difficult for banks to understand?

Mr Cassimatis—I cannot answer for the banks. I cannot answer that. I know they did understand it.

Senator MASON—You will have to bear with me; finance is not my strong point. I am, as the chairman alluded to, one of those who need education in this area. When people invest they necessarily undertake a certain amount of risk, don't they?

Mr Cassimatis—There is nothing that is riskless.

Senator MASON—Sure. Would you accept that margin lending is a legitimate and useful way to build up personal wealth?

Mr Cassimatis—Yes.

Senator MASON—When there is margin lending, the relationship is between the bank and the client, and Storm would in effect just be the agent. Is that right? Because the bank in a sense is bearing a risk.

Mr Cassimatis—Could you ask the question again.

Senator MASON—When someone has taken on a margin loan the primary relationship is between the bank and their client—the person who takes out the loan—because the bank is of course bearing the risk.

Mr Cassimatis—Yes.

Senator MASON—And Storm simply operates as the agent?

Mr Cassimatis—Of whom?

Senator MASON—Of the bank.

Mr Cassimatis—No.

Senator MASON—Of the client?

Mr Cassimatis—No, Storm is the adviser of the client. And storm is certainly not the agent of the bank.

Senator MASON—So the primary relationship is between the bank and the client in a margin loan.

Mr Cassimatis—Yes, as is the relationship between the fund manager and the client. The client is the beneficial owner of the units and the fund manager manages that.

Senator MASON—Are margin calls made on the basis of a trigger based on loan-to-value ratio? You hit a trigger and then a margin call is made.

Mr Cassimatis—Yes, the trigger is the margin call.

Senator MASON—And that is based upon a loan-to-value ratio?

Mr Cassimatis—Yes.

Senator MASON—It can be set at 50 per cent, 60 per cent or 70 or 80. Is that right?

Mr Cassimatis—Yes.

Senator MASON—We have heard a lot of evidence over the last few days about some people saying they did not want to take any risk and others wanted to take much more risk. When people came in to see Storm seeking financial advice, how was the trigger set for the margin call?

Mr Cassimatis—The producer of the product, which is the bank, set the trigger.

Senator MASON—In all cases?

Mr Cassimatis—In all cases.

Senator MASON—Were your clients that you were giving financial advice to made aware of that?

Mr Cassimatis—Yes.

Senator MASON—So all the clients of Storm would know that, for example, there would be a margin trigger when the LVR hit, let's say, 60, or 70 or 80 per cent, depending upon the product? Is that right?

Mr Cassimatis—Correct.

Senator MASON—If the LVR required to trigger a margin call were to be changed from the initial rate—upwards or downwards—that should be done in consultation with the client and they should be informed, don't you think?

Mr Cassimatis—Banks usually do not refer to their clients when they set these buffers and margin call limits, but they do inform their clients.

Senator MASON—Let me just get that right. Let us say you have product X and when someone signs up it is, let's say, 60 per cent LVR. But then the banks want to change it to, let's say, 70 per cent.

Mr Cassimatis—Let's include that interest rate. So they sign up, they have got an LVR of—

Senator MASON—I just want to keep it simple. I want the principles here.

Mr Cassimatis—The principle. I am trying to be helpful with the principle.

Senator MASON—The fact that the LVR has been changed from, let's say, 60 per cent to 70 per cent—

Mr Cassimatis—Or the interest rate changed from seven to eight.

Senator MASON—Sure. That would be communicated by the bank to the client, would it?

Mr Cassimatis—Yes.

Senator MASON—In all cases.

Mr Cassimatis—Yes.

Senator MASON—So any change to loan-to-value ratio on every product would be communicated by the bank not to Storm but directly to the client. Is that right?

Mr Cassimatis—Yes.

Senator MASON—How are margin loans triggered? What is the actual process for that to happen?

Mr Cassimatis—I am sorry?

Senator MASON—Is it automated in the sense that as soon as it hits, say, 80 per cent on a particular product—

Mr Cassimatis—I am not understanding the question. Please repeat it from the beginning.

Senator MASON—Sure. The trigger rate is reached—

Mr Cassimatis—Sorry, the trigger—

Senator MASON—The trigger is reached; let's say 80 per cent.

Mr Cassimatis—For a margin call.

Senator MASON—Yes, for a margin call. Let's say it is 80 per cent. It is reached. What happens?

Mr Cassimatis—The bank notifies the client. That is what used to happen. A letter is created each day and that gets sent to the client along with a copy to us, in this case. That is what used to happen—the moment it happened; it used to be within 0.1 per cent or 0.2 per cent.

Senator MASON—I assume that would in effect be automated. Is that right?

Mr Cassimatis—Yes.

Senator MASON—So it happens automatically: a letter is generated from the bank.

Mr Cassimatis—Yes.

Senator MASON—Is that right?

Mr Cassimatis—Yes, as I understand it.

Senator MASON—What is Storm's role in that relationship?

Mr Cassimatis—I can tell you what the role used to be—

Senator MASON—Would a copy go to Storm as well—in other words, to notify them that the margin call had been made?

Mr Cassimatis—Yes. A copy would go to Storm, the original will go to the client and, typically, we would get a call from the client, or, if the adviser was proactive, he or she would contact the client, as the adviser. But, typically, the client would come to Storm and say, 'Hey, I have got this; what do I do?' Then we would say, 'Do X, Y or Z.'

Senator MASON—And give them, in a sense, financial advice, which they are paying you for. I know my colleagues and I have asked this question many times over the last few days: so many people have given evidence that they did not receive these margin calls; do you know why they did not? All over the country people were receiving margin calls but they did not with Storm, and no-one yet has given me a satisfactory answer to that. Can you explain that?

Mr Cassimatis—I certainly wish I could explain. I asked to table some documents before, and I have in these documents maybe some clues. I tried to gather as many documents as I could to give as much information as possible that would answer these types of questions. Could I refer to one document?

Senator MASON—I do not want to go into evidence too much, because we are legislators. We are not really after individually culpability. That is not our concern.

Mr Cassimatis—You asked the question as to why, and I am using a tool to answer the question.

Senator MASON—I want to know about the process.

Mr Cassimatis—You asked why the process broke down.

Senator MASON—Yes. Why?

Mr Cassimatis—If I can use the tool at my disposal I might be able to help answer that.

CHAIRMAN—We would need to see it first—simple as that. We are not just going to accept documents without knowing what they are.

Mr Cassimatis—I can explain what they are. Do you wish to see it?

CHAIRMAN—That is what I am saying.

Mr Cassimatis—I presume I will get this document back.

CHAIRMAN—Give me a look at the document, and then yes. While we are doing that, Senator Farrell has the call.

Senator FARRELL—Thank you for coming along today. One of the terms of reference that we are looking into here is the nature of the commission structure that applied to a number of these financial products. We heard yesterday in Townsville people give some evidence that they were paying many tens of thousands of dollars upfront by way of commission. Could you go into some detail about what the commission structure of Storm Financial was?

Mr Cassimatis—Thank you for asking that question. I have documents here to go into that. I am quite surprised at the restriction on being able to actually give information out. I will need to refer to these documents, if I may, to answer that question. Do you need to check with the chair?

Senator FARRELL—Please just explain it to me.

Mr Cassimatis—Are you specifically asking about Storm's commission structure?

Senator FARRELL—Yes. Could you explain to us how the commission structure worked?

Mr Cassimatis—There has been a lot of press about the Storm fee structure and the percentages and so on, things like seven per cent upfront, and that is true. There is, of course, nothing worse than half of the truth. I took the liberty of doing some research and doing some calculations in order to explain a question of that nature. There are, when calculating fees, a plethora and a number of fees that apply. One of the things that I did early in the piece in establishing the model was to look at the nasty bits and where they existed. I determined that one of the areas which had the most deleterious effect on portfolios was that of fees.

So the types of fees that exist are: (1) upfront fees; (2) a thing called a buy-sell spread fee; (3) an ongoing fund manager fee; and (4) the adviser service fee which comes in on top of that. They are basically the main ones. There are commissions for margin lending products and commissions for managed funds et cetera ongoing and upfront.

When I actually sat down and did the numbers I found that the insidious part of all fee structures was the ongoing rather than the upfront. So I determined that when creating the Storm investment model we would to the extent possible—

Senator FARRELL—If I could stop you there, are you saying that you looked at this before you set up Storm?

Mr Cassimatis—It was part of setting up Storm. It is part of this ongoing model T Ford developing.

Senator FARRELL—So you are saying that you looked at fee structures in other financial products.

Mr Cassimatis—Yes, and researched them quite extensively and determined that we wanted to be in the lower end of the spectrum if not the lowest end of the spectrum.

I have done two comparisons. We had big cases and small, or smaller, cases. In other words, the cases that were half a million or above carried a lower fee structure and cases that were half a million or below carried a higher fee structure which reduced when they crossed the line to half a million. To give you an example, I compared two cases: one where I used industry averages and the other one where I used the Storm fee model. I tried to be generous to the industry model and used an upfront free of one per cent. I used a Storm fee of seven per cent, keeping all the other parameters the same—in other words, market earning rates and so on—so that we could highlight the difference solely as a consequence of the fees. Of course, the Storm upfront free for \$200,000 was \$14,000 at seven per cent and at one per cent it was roughly \$2,000. One would expect the Storm fees to be much higher. But when I did the calculations I found that along the way from a point roughly four years after the plan had been implemented, if I used a period of 20 years, the total client fees to Storm would be \$130,000 and the total client fees in the industry average case would be \$282,000. More to the point, the difference in the portfolio would be \$1.78 million compared to \$1.48 million—a difference of \$300,000 in favour of the Storm portfolio solely as a consequence of the fees.

Senator FARRELL—Was the fund you are comparing with one that survived the crash so that the people have still actually got their money?

Mr Cassimatis—No, because we used indexed funds and they tend to perpetuate. But this was the case from year 4 onwards, and that had become quite significant. So I have prepared for this committee not only a set of tables but also a set of graphs to show this. And it is quite extraordinary. In this particular case, the detrimental effect of the ongoing, which is absolutely enormous, meant that after 10 years the Storm upfront fee would need to be 12.63 per cent to equal the industry fees.

Senator WILLIAMS—I would like to make a point of relevance. We have limited time and we are not here to argue whose fees were the highest or the lowest. I think we should get back to the nuts and bolts, if that is okay.

Mr Cassimatis—Has that answered your question?

Senator FARRELL—I think we need to be clear. Your structure included an up-front fee of seven per cent.

Mr Cassimatis—And a much lower ongoing fee. I can say that I have not come across a plan—and I have studied many—that have lower overall fees than the Storm fees.

Senator FARRELL—What were those ongoing fees? Can you just tell us what—

Mr Cassimatis—It is 1.14 per cent in total. I understand that Storm was the only advisory firm that paid the buy-sell differential on behalf of clients. Our fee structure was certainly quite low, contrary to what is being touted. Am I able to refer to the previous document?

CHAIRMAN—The committee generally prefers not to accept documents that may be used in another forum, in terms of any other proceedings. Having had a look at those documents, I am not prepared to accept them. We will kindly return those documents as they stand.

Mr PEARCE—Thank you very much for being with us this morning. In your opening remarks and in answers to the Chair's questions, you said that you were responsible for the strategic direction of your company. Can you share with the committee the strategy of your business?

Mr Cassimatis—The offering was to be able to put any Australian in a position where they could accumulate their own wealth. The sorts of clients we attracted were ones who did not want to be burdensome on systems, on the social security system, and would prefer to run their own race. We tried to build a model that we believed was safe to allow them to reap the rewards of capitalism and build wealth in a quite sober and conservative way, contrary to what is floating around out there. Once we thought we had succeeded in that, our view was to roll that out across the country and make it available to all Australians. We have an expansion process. We sought capital on a number of occasions from various players and, in the main, we commenced our expansion organically. That is a very slow process, as you would know, so we then tried to accelerate that with an IPO or other types of funding.

Mr PEARCE—Our terms of reference particularly highlight the role of financial advisers. I would like to ask you a couple of questions in relation to financial advisers who worked for your organisation. Firstly, can you tell me how you recruited financial advisers?

Mr Cassimatis—I do not think 'recruiting' is the word. They knew us and were more attracted to us than the other way around. Recruitment started quite late in the piece. At the point where Storm Financial collapsed, we would have recruited a couple of people. The rest were industry colleagues who knew our model, were attracted to it and were receptive to coming on board. The recruitment drive started later in the piece. We had a national manager responsible for recruiting. He seemed to be quite a presentable sort of guy—Mr Ron Jelich. He flitted around the country and made contact with lots of people. As I said, that recruitment was late in the piece. Prior to that, the advisers were people who knew us and knew of us over many years and were quite happy to be associated with us.

Mr PEARCE—How did you train or educate your financial advisers on your range of products and services? Take a hypothetical situation where somebody joined your organisation and came on board. What process did you take them through in terms of educating them?

Mr Cassimatis—In the main, the ones who had come on board were already educated in we did. They were already in the same space. They had used gearing a lot, they had used margin lending a lot and, indeed, they had used index funds a lot. They had seen how we had operated over a 10- to 15-year period and they themselves had emulated that. So they knew it roughly around the edges, so we just needed to polish things.

Mr PEARCE—How did you do that?

Mr Cassimatis—One of the things was to reduce LVRs, for example. I tended to find that in their own businesses and operations they tended to go straight to whatever the maximum was at the time. If it was 66.67 per cent, they would gear people to 66.67 per cent. Our ratios were somewhat more conservative. We had a compliance sell. We found in 2003, following September 11 and the Iraqi war, that we had a concentration of margin calls. They were not a huge number but sufficient for us to want to change policy. We then made our LVRs a bit more conservative or, to put it another way, made our buffers bigger. In other words, we tried to increase the safety margins.

Mr PEARCE—Yes, but, with respect, that is not my question. My question is: how did you go about training and educating the advisers who worked for you in your business about the products? I understand what you are saying in terms of the outputs, but what did you do to train them?

Mr Cassimatis—We had quarterly training sessions where everyone would get together. When someone first came on board a more experienced adviser would mentor them, sit with them, watch how they operated and do things with them and for them. That was a gradual process and it took some time—weeks, months and up to a year. Then they would become more autonomous as they understood what the store model was. There was always access for them to me and others who were more senior.

Mr PEARCE—I want to ask you a question about who owned, for want of a better term, the customer. You mentioned in your opening remarks on a number of occasions and subsequently in answers to questions from my colleagues that the banks would make contact with the customers. Who owned the customers? Were they your customers or were they the banks' customers?

Mr Cassimatis—The practical answer is that nobody owns another person. They own themselves. Customer owns themselves. They are free agents. In terms of the dealership relationships, when an adviser came in the dealership would own the customer—but not in a technical sense—for products not regulated. For home loans or margin loans, for example, they would be bank customers, and the bank saw them as such.

Mr PEARCE—If I walked into one of your businesses—say, the clock has been wound back a couple of years—sat down with one of your advisers and went through the process, and I decided to acquire a margin loan, for example, with hypothetical bank Z, are you telling me that I would have done the transaction directly with the bank?

Mr Cassimatis—In what sense? You would have gone into the bank premises and done the transaction?

Mr PEARCE—Yes. Explain to me how that would have worked?

Mr Cassimatis—We would pick up a brochure off the shelf for a margin loan, assist the customer to fill it out and then lodge it with the bank.

Mr PEARCE—You would lodge it with the bank?

Mr Cassimatis—The margin loan document would be sent with the assets that that margin loan was acquiring. That application would go to the bank, yes.

Mr PEARCE—Then I would have a direct relationship with the bank after that if my application was successful?

Mr Cassimatis—Yes. All the information would flow from the bank to the customer and only copies would flow to the advisers or to Storm. Each quarter or each month, a customer would receive a statement directly from the bank—not from the bank to Storm—that would outline all the LBRs, all the buffers, all the information and all the statistical stuff.

Mr PEARCE—You said that you spent, I think, 199 or 200 days educating customers—is that right?

Mr Cassimatis—No, I said it took approximately 200 days on average from the day the customer walked into a business or came through the door until they invested, if they became a customer. Of four customers who would walk in, one would become a client.

Mr PEARCE—That one client would take on average 200 days before they invested?

Mr Cassimatis—Correct.

Mr PEARCE—Do you think that is a normal time period?

Mr Cassimatis—No.

Mr PEARCE—Can you explain why it is not a normal time period?

Mr Cassimatis—Usually the industry tries to make sales, so to speak, on the spot. In fact, one of our policies was that if someone was ‘dead keen, real quick’, we would slow them down. There were the odd occasions where we actually declined clients. We needed to be reasonably satisfied that they had gone through the education process and, to the extent possible, that they had had enough contact and enough time to digest.

I note that there is a particular client currently taking an action against one of the banks. That particular client originally looked at the process in 2003 and declined to proceed. Then that person, of their own volition, came back, I think, in 2006 and decided to proceed. That particular person has multiple degrees and is highly intelligent, so he knew.

CHAIRMAN—You said it took on average 200 days to get in. How many days did it take them to get out?

Mr Cassimatis—Is that a rhetorical question?

CHAIRMAN—No, it is a serious question. If it took people 200 days to get in, how many days did it take them to get out?

Mr Cassimatis—If that is how you understood my statement, I probably need to clarify something. It did not take 200 days to get an investor in; it took 200 days to think things through.

CHAIRMAN—For you or for them?

Mr Cassimatis—I do not understand.

CHAIRMAN—Who had to think, you or the client?

Mr Cassimatis—We both have to think.

CHAIRMAN—Why? If they were referred by friends or family and they had already made a decision that they wanted to invest, why did it take so long to allow them into your system?

Mr Cassimatis—You have somehow twisted my words.

CHAIRMAN—I am just asking the question; I am not twisting any words.

Mr Cassimatis—That was not an allowance into the system. That is how long it took. They would come in and they would do the workshop. Sometimes they would attend two or three times. They would come back. That is just the number that fell out. On day 1 someone would walk through the door. Day 200 on average is what it would take to invest.

Senator WILLIAMS—Mr Cassimatis, thank you for your attendance today. We have heard in the last few days the sad stories where everything has gone pear shaped. But I want to get back to what we as legislators need to look at in relation to preventing this in the future. We had LVRs, trigger points, margin calls—call them what you like. For example, I believe CGU had with your product a 90 per cent margin call. Is that correct?

Mr Cassimatis—Say that again?

Senator WILLIAMS—CGI, sorry; it was wrong. CGI was at a 90 per cent margin call?

Mr Cassimatis—Yes.

Senator WILLIAMS—Why weren't those margin calls done at 90 per cent? I ask the question on the grounds that when the stock market, the ASX 300, was rapidly falling, people's security, life earnings and, in many cases, homes were at risk. Why were they not cut off at 90 per cent?

Mr Cassimatis—In the absence of my being allowed to use documents, how am I going to answer that question?

CHAIRMAN—Like with any other questions.

Senator WILLIAMS—What I am saying is this, Mr Cassimatis. There was a stopgap, a hedge point, placed in everyone's contract.

Mr Cassimatis—There should have been.

Senator WILLIAMS—I am sure there would have been, wouldn't there?

Mr Cassimatis—Yes, there was one in the contract.

Senator WILLIAMS—When that point was triggered, the margin call, why didn't CGI, the financiers or whoever cut them off there so that the Storm clients did not proceed further into debt? I have even got one customer who told me of a 143 per cent LVR. Why was this ever allowed to go through that stage? That is what I want to know, because we need to know these sorts of things to make sure that this does not happen again even if it requires legislation or amendments or whatever. This is what we need to know. Why didn't the gate drop and stop those people from losing the rest of everything that they have earned in their life?

Mr Cassimatis—I can answer that question in two ways. One way is please ask the bank. Please ask Mr Norris as to why those formal notifications did not go out. That is who you need to ask. Would you like me to speculate as to an answer as to why it did not happen?

Senator WILLIAMS—Yes, give us your opinion. You are free to speak under parliamentary privilege.

Mr Cassimatis—Can I show you a graph?

Senator WILLIAMS—Or explain the graph.

Mr Cassimatis—The data was scrambled. They did not have the data. They were behind in the data.

Senator WILLIAMS—So as to what you are saying 'they' being who?

Mr Cassimatis—The system. The CGI system.

Senator WILLIAMS—Okay, so they had a computer system—

Mr Cassimatis—Yes.

Senator WILLIAMS—and it was way behind and was not keeping up with the rapid fall of the market. Is that what you are saying?

Mr Cassimatis—Correct.

Senator WILLIAMS—Okay, proceed.

Mr Cassimatis—The data was way behind. In October-November we knew that the data was behind but we could not easily prove it. I would have thought it was easily provable because you just know it is behind. I have been asked, ‘How did you know?’ There must have been parameters that indicated that. If you speak to our staff in charge of that cell, it was a screaming match with CGI—‘The data’s behind. We don’t know where everything is.’ We believe we can now prove that, and I can show you certain graphs that demonstrate that. So I think it was simply a mistake and their data was behind.

Senator WILLIAMS—First off then, why was their data behind? Did they, in your opinion, not have enough manpower to feed the data in or was the computer program they were using not up to scratch?

Mr Cassimatis—I understand—

Senator MASON—Was the problem only in relation to Storm clients?

Mr Cassimatis—We were the biggest single volume. But Carmela Richards tells me that they only had—if not even—a handful of people handling all the accounts.

Senator WILLIAMS—14,000 accounts or something?

Mr Cassimatis—No, it would have been like 4,000 accounts.

Senator WILLIAMS—About 4,000?

Mr Cassimatis—14,000.

CHAIRMAN—How many did you have handling the accounts, Mr Cassimatis?

Mr Cassimatis—More than CGI had. The data was simply wrong. It caught up. It was some time in mid to late November that the data caught up, and I could show you the calculations that I have been painstakingly working on over the last few weeks. I think they just had a panic moment. It was at a point in time, if you recall, when at least one of the banks, which I have been notified by this government, was on the verge of insolvency; if it was not insolvent government had to step in and guarantee. All the banks were panicking. Things were quite rugged. So I think they just called in the credit. I have made that statement in my opening remarks. So they panicked, hit the buttons and what happened after that is what was wrong. It is where they tried to lay the blame.

Senator WILLIAMS—The point I make is the gates should have come down on that 90 per cent, which to me is still a very high LVR. Why is that high? But anyway I certainly would—

Mr Cassimatis—I could answer that too.

Senator WILLIAMS—Why was the LVR so high at 90 per cent?

Mr Cassimatis—In 2003 we found that when we did our analysis we wanted to extend things so that it would cover much larger events than September 11 and the Iraqi war issue. So we took two policy decisions to increase the safety, so to speak—

Senator WILLIAMS—In other words, to broaden the terms so people would not get a margin call?

Mr Cassimatis—Yes.

Senator WILLIAMS—That is fine but it is also increasing the risk anyway.

Mr Cassimatis—In hindsight, however, that made it more difficult.

CHAIRMAN—Before, Mr Cassimatis, you said you kept your LVRs lower than others. So others were higher than 90 per cent?

Mr Cassimatis—I think you are confusing something.

CHAIRMAN—I must be.

Mr Cassimatis—The starting LVR was lower than the people that had come to—

CHAIRMAN—What is the important LVR: the starting or the finishing one?

Mr Cassimatis—The devastating one is the finishing one, of course.

CHAIRMAN—That is fine; thank you.

Mr Cassimatis—But the implication out there has been that we started people at 70 and 80 per cent.

CHAIRMAN—You certainly finished them on some pretty high numbers.

Senator WILLIAMS—Mr Cassimatis, in your program you at any stage, with the agreement of your client, could convert those investments into cash. Is that correct?

Mr Cassimatis—Yes.

Senator WILLIAMS—Obviously, in October, from what we on this committee have heard, your clients were getting letters: ‘Please sign this urgently. We are going to convert 50 per cent of your investments into cash.’ Then the next day they got: ‘Sign this one. It is 100 per cent.’ Obviously, you were prepared to take steps to take the risk factor out of relying on the market with your investments and converting them to cash. Why didn’t you do that?

Mr Cassimatis—Firstly, the letters that went out were ‘up to 50’ and ‘up to 100 per cent’.

Senator WILLIAMS—Whatever it was.

Mr Cassimatis—It was ‘up to’. In October we actually started that process. Hundreds and hundreds of millions of dollars were being converted.

Senator WILLIAMS—They were taken out of the ASX 300 and going into cash?

Mr Cassimatis—Correct.

Senator WILLIAMS—Okay, continue.

Mr Cassimatis—That process was started. That also started another chain of events where the systems that managed those moneys could not cope. They did not have sufficient resources.

Senator WILLIAMS—Whose systems: yours, CGI’s or the banks’? Whose systems are you talking about?

Mr Cassimatis—In fact, of the three players—the fund managers, CGI and Storm—I think Storm had the highest capability. The fund managers were unable to do the redemptions in a timely fashion—not through any fault of their own; that is just market forces—so the funds got suspended.

Senator WILLIAMS—When you say ‘the funds got suspended’, that jumping off one floor and onto a safety net into cash came to a stop, did it?

Mr Cassimatis—They were unable to process those volumes of redemptions. What made things more difficult is that the gatekeepers were the margin lenders, so all requests had to go through them. That was a huge double-handling process. We offered to help. Carmela offered to help, with our agreement, the people at CGI process the redemptions by sending them direct to the fund manager.

The sheer volume of dollars that were going into cash gummed up the system and had the fund suspended. That had the effect of the margin lender not knowing or having a handle on the unit prices. Once the fund is suspended there are no unit prices, and the unit price is not struck until the fund is unsuspended. CGI was probably running dark and did not have the information.

Senator WILLIAMS—When this all went pear-shaped you could not get them into cash and the systems could not cope, did you then urge the Commonwealth Bank to ride it through, if I could put it that way, having probably rightful confidence that the market would recover sometime in the future? Did you then try to take the whole Storm investment through the slump of the stock market in the hope it would return?

Mr Cassimatis—No, that is not quite an accurate characterisation. It is a bit of summary but it has inaccuracies in it. In 2002-03 errors occurred particularly with CGI at that time and it was somehow in their unit record. Then a similar event happened when suddenly clients went into margin call, who previously would not have know that they would be in margin call, because of the CGI errors. At that time we spoke to them and said, ‘Let’s please work through this together,’ for the client’s benefit, ‘There had been an error made here. Don’t do what you have to do,’ and

they cooperated fully. There were never any formal agreements with CGI as to procedures and operating techniques. We tried to formalise that by coming up with some sort of agreement, of which I have a copy but I have been informed not to hand it in. That was instigated by me because I was worried that, at the time, we had verbal conversations but the bank had no obligation to be helpful to clients. I tried to pin them down a little bit by saying, 'If something should happen in the future, then please let's work together to assist to clear these margin calls.' So in 2002-03 they were most helpful on that occasion. On 4 December Storm offered to CBA, they used a window in there to do certain other things that they should not have done, and the rest is history. So, yes, we did offer.

Senator McLUCAS—Our first term of reference is to investigate the role of financial advisers. What do you think the role of financial advisers is?

Mr Cassimatis—I think the role of financial advisers is to assist clients navigate the complexities of what is out there in terms of product and, more importantly, in terms of understanding outcomes.

Senator McLUCAS—How do you do that?

Mr Cassimatis—By keeping them informed or through setting up mechanisms that allow them to be informed to the extent possible, and guiding.

Senator McLUCAS—As part of that were there education sessions offered by Storm?

Mr Cassimatis—That was part of it.

Senator McLUCAS—What did they cover?

Mr Cassimatis—It covered technical aspects of finance, the psychology of investing, accounting principles, financial principles and risk. Specifically, because our space was leverage, it gave explanations as to how wealth can be enhanced significantly using leverage, and it also gave quite horrific examples of how equity gets destroyed when markets are negative, but then in the end it is the averages that count.

Senator McLUCAS—I understand there were different types of educational sessions, but what proportion of the time in the total amount of training or education you were providing to potential clients would be attributed to the specific product you had, which you said was about using leverage?

Mr Cassimatis—I am not sure, without looking back and doing an analysis, I can give you an answer to what proportion.

Senator McLUCAS—A ballpark figure?

Mr Cassimatis—I cannot even give you a ballpark figure. A wild stab in the dark would be 10 per cent. I do not know.

Senator McLUCAS—Ten per cent?

Mr Cassimatis—That is a ballpark, wild stab in the dark figure. I have already answered that I do not know.

Senator McLUCAS—How much time would have been spent, say, on the value of investing in superannuation?

Mr Cassimatis—The time would have been spent on the value of investing as opposed to the value of investing in superannuation. Superannuation is a taxation device, so the investment process is the same whether it is within superannuation or outside of superannuation. In the accounting section there would have been discussions about superannuation.

Senator McLUCAS—You quite openly and honestly said you have a specialised product and you kept yourself to that product, and I thank you for saying that, but I go back to what you think the role of a financial adviser is. I think ‘financial adviser’ is a bit different; it is a broader thing. I wonder if you could talk more about that.

Mr Cassimatis—A financial adviser’s role is broadly to understand aspects of finance generally, which includes basic accounting principles—for example, understanding the difference with money sitting in a superannuation fund, a unit trust or a company account, being able to navigate these things for clients should they have questions and being able to make recommendations as to what they think is the best thing for that particular client.

Senator McLUCAS—Let’s look at it this way: people come along to the education sessions and eventually they come to a view that it is appropriate to invest in the model that you promote, which is a leveraging model. They are, in my view, self-selecting in.

Mr Cassimatis—Yes.

Senator McLUCAS—You agree with that?

Mr Cassimatis—Yes.

Senator McLUCAS—How do you, under the Corporations Act, ensure that if they are self-selecting in you have complied with the ‘know your client’ section? How do you do that as a financial adviser?

Mr Cassimatis—You gather all of the information. You have all the client’s physical information. You have to understand and know their circumstances and then match those circumstances up with the desires that they have. A person has circumstances and they also have desires. Sometimes their desires do not match their circumstances. Sometimes their desires cannot be met by those circumstances.

Senator McLUCAS—You said that on the odd occasion you declined clients.

Mr Cassimatis—Yes, on the odd occasion we declined clients.

Senator McLUCAS—So you very rarely said to a client, ‘Look—

Mr Cassimatis—This was after self-selection.

Senator McLUCAS—Yes, but how many times would you have advised a client that investing in, say, property would have been a better option for that particular individual?

Mr Cassimatis—Property was not off the list. I would say not all but almost all clients who came to us—I cannot think of an exception—were very significantly overweight in property. We believed in a balanced investment approach. Almost everyone who walked through the door had the majority of their assets sitting in property. We did the analysis of what percentage each client had in property, in cash and in shares. Off the top of my head I cannot remember what our recommended balance was, but we certainly had a recommended amount that should be in property, in shares and in cash. In the majority of cases people were overweight in property.

Senator McLUCAS—How did you ensure that the choices people made to self-select were informed choices?

Mr Cassimatis—Part of that 199 days is the answer to that. We went slowly, we gave them—

Senator McLUCAS—Sorry, Mr Cassimatis: how, not time. How did you do it? What were the forms you filled in? What were the operations of the business to ensure that?

Mr Cassimatis—The workshop that they attended, the education sessions that they attended in the very first instance. The statement of advice. I am not sure if you have read a statement of advice. You would see in there it is quite comprehensive and quite informed. What is missing out of that?

Senator McLUCAS—They are very long documents, as I am sure you know. Do you evaluate people's understanding after the workshop?

Mr Cassimatis—I am sorry?

Senator McLUCAS—Did you evaluate a potential client's understanding of the processes after the workshop?

Mr Cassimatis—One of the things we did was have advisers go through the statement of advice and come to a conclusion that, yes, there is pretty much—the average client is not sophisticated to the extent that they would fully understand that. It was not about having full understanding; it was about having sufficient understanding. The occasions that I referred to where we declined clients were where we believed they did not have sufficient understanding. We went to great lengths to educate them about the differences in the asset classes, about the effect of leveraging in both directions et cetera.

Senator McLUCAS—We have had a number of people talk to us. You can have a look at the *Hansard* and have an understanding of the number of people—not all—who have talked to us about not understanding how gearing worked and leveraging, but that is for another day. Finally, I want to go to the structure of the organisation. You said earlier, in response to another question, that 'rather than recruit people, they came to us'. I understand how that happened with a number of smaller organisations becoming part of Storm. When that occurred, how did you make sure

that your responsibility as the licensee was complied with in terms of the relationship between yourself as the licensee and your representative?

Mr Cassimatis—We had quite significant compliance cells. Every piece of advice was vetted by the licensee. In fact, I believe that was one of the cornerstones of our model.

Senator McLUCAS—Did you have a checklist? How did you evaluate the ability of those people who came to you to comply with your obligations as the holder of the licence, for them to be a representative of you?

Mr Cassimatis—They did the usual courses. We tried to lift the level of knowledge by assisting people to go through higher levels of education, such as the master of applied finance degrees. In fact, at the time Storm went down, something like 30 were halfway or three-quarters of the way through. That was the second round.

Senator McLUCAS—I am meaning earlier in the piece. When they came under your responsibility as a licensee, was there a formal assessment of the capability of someone who was going to be your representative under the act for you to feel confident that they were competent to do the work that you were expecting of them?

Mr Cassimatis—Firstly they had a level of competence because they had come from other dealers.

Senator McLUCAS—You need to assure yourself of that, surely.

Mr Cassimatis—Sorry?

Senator McLUCAS—You needed to assure yourself of that.

Mr Cassimatis—If you will just bear with me: they already had a level of competence and most of them I knew personally. That evaluation cannot happen in a day; it happened over time. So as we were confident that they were competent then we allowed them to carry more of the advisory burden. They were supervised, particularly early in the piece, to see that they understood, and that happened quite strongly. There was one person in particular who did not really wrap his head around numbers that well, but he was attached to someone who could as a heavy assistant. So he did none of that type of work. Yes, we looked at that constantly.

Mr ROBERT—Mr Cassimatis, No. 9 of the terms of reference deals with legislative or regulatory change. As you would be aware, chapter 7 of the Corporations Act deals with the issue of registration and conduct of financial products, of which margin lending is currently not governed by chapter 7. The Reserve Bank tells me that in the middle of last year there were 206,000 Australians with margin loans out there, and by September of last year 2,000 Australians a day were getting margin calls. So it seems like margin calls were happening right across the nation, except for, Sir, in your company.

Mr Cassimatis—Yes.

Mr ROBERT—Storm Financial alone seems to be the one place where it did not happen, so I find your opening comment with respect to the banks being at fault to be strange. If they were at fault, we would have seen it across the nation, but we did not. We just saw it in Storm.

Mr Cassimatis—Correct.

Mr ROBERT—Now you said in your opening statement that the protocol used in 2002-03 by CGI was switched off. When you used the term ‘protocol’, what did you mean?

Mr Cassimatis—Whatever the process was to physically issue the margin calls. I cannot imagine any other reason.

Mr ROBERT—Was that protocol in writing with you?

Mr Cassimatis—No, it is just a mechanism whereby the margin calls get issued. I do not know why it was switched off. The margin calls did not go out. The margin call notices did not go out. One went through.

Mr ROBERT—Did you know what the process and the protocol were for margin calls to occur with each of the institutions you dealt with?

Mr Cassimatis—I assumed it was all similar. There would be notices that would go out.

CHAIRMAN—But Mr Cassimatis, how did you know it was switched off if it did not exist, if you did not have an agreement? How did you know?

Mr Cassimatis—How did I know?

CHAIRMAN—Yes, how did you know. Did someone write to you or ring you?

Mr Cassimatis—Can I go back to that document?

Mr ROBERT—Just tell us. Billions of dollars of clients’ money, how did you know it had switched off?

Mr Cassimatis—I am assuming it was switched off. Until this period—

CHAIRMAN—It is a big difference, though. It was switched off and now you are just assuming it was switched off. I do not know, is it the same or not the same?

Mr Cassimatis—Until this period, the margin call notices went out. We have proof of those. We have the copies of them, so there had to be something that sent them out. They did not fall like manna from the sky; they went out.

Mr PEARCE—So when they stopped going out, what did you do?

Mr Cassimatis—We did not know they had stopped going out.

Mr ROBERT—How can you not know, Sir? You know exactly the financial position of your clients. You know when the LVR has been exceeded. How could you possibly not know that someone was not in breach of the LVR and a margin call was in play?

Mr Cassimatis—Because we got no notices.

Mr ROBERT—No, forget the notices! You know your clients' financial position, you know what the LVR is, you know the state of the market index they are in, you know when the LVR has been breached. How could you possibly not know that a margin call had not been sent?

Mr Cassimatis—If I can show you this document—

Mr ROBERT—Just tell me, Sir, how you could not possibly know?

Mr Cassimatis—Your question assumes that the data feeds were correct.

Mr ROBERT—My question assumes your financial advisers actually knew the financial position of your clients, which is your fiduciary responsibility holding a licence.

Mr Cassimatis—You can only know the financial position of a client if, for example, a fund manager gives you the balance of an account. You can only know that if there are individual stocks and if there is a price on that stock. You cannot know it if there is no price. You cannot know it if you are not getting data. You cannot know it if you are not getting correct data.

Mr ROBERT—At any stage did your advisers—

Mr Cassimatis—I gave evidence earlier that said that we knew the data was wrong. We can now prove the data was wrong.

Mr ROBERT—At any stage did your advisers calls CGI and other providers to say: 'We're unsure about the data. Can you please let us know if our clients' LVR has been breached?'

Mr Cassimatis—The compliance cell did, yes. Carmela Richards.

Mr ROBERT—And what was the response?

Mr Cassimatis—'No, our data's correct.'

Mr ROBERT—With respect to the various protocols you said you used in 2002-03, the question I asked previously was: were they in writing and was the process known and understood? Were the protocols with CGI and other providers in writing and was it well understood how they would work?

Mr Cassimatis—There was nothing in writing in 2002-03.

Mr ROBERT—Later on, post-2002-03, leading up to the collapse, was there something in writing? Was there a clear protocol and process for how margin calls would be exercised?

Mr Cassimatis—No, there was not.

Mr ROBERT—Andrew Jackson, from the bank, yesterday said there was an agreement between Storm and CBA that Storm would handle all margin calls. Are you saying he is incorrect?

Mr Cassimatis—Yes, I am saying that.

Mr PEARCE—Just to follow on from that question: you mentioned that you knew the data was incorrect and that your compliance cell informed the lenders of that.

Mr Cassimatis—Attempted to.

Mr PEARCE—So when you learnt that the data was incorrect, what did you do in relation to your clients?

Mr Cassimatis—In early October we simply were working on what the market was doing and we were attempting to get people into cash to the extent that we possibly could. But we did not know how much we should get into cash, what percentages. We just did not have a feel for that, so we were running blind.

Mr PEARCE—Is that what you told your clients?

Mr Cassimatis—I think so, yes. We told our clients in October and November. I had investor updates in which I said: ‘Look, we’re all in one of I think five or seven positions, but at the end of it we don’t know what the position is until the data that we get from the margin lenders is clarified.’ I did presentations to that effect.

Senator MASON—Mr Cassimatis, you told me in the evidence to the committee that these margin calls were generated automatically. That the LVR was hit and then a computer generated these margin calls. Why didn’t it happen to your Storm clients?

Mr Cassimatis—You tell me! It did happen in 2002-03. Why did the notices not go out in 2008?

Senator MASON—We are not talking about abacuses and slide rules. It is a different world today; these things happen automatically. That was your evidence. You have thousands of clients who are not being informed. What are you doing about it?

Mr Cassimatis—In November and October the speed of events was diabolical. There was a 30 per cent fall from, I think, November 2007 to October 2008. In the next month there was a further 30 per cent fall. There were days in there when there were 15 per cent falls. Things were bedlam. Who was catching up with the information?

Senator MASON—But everyone else received margin calls.

Mr Cassimatis—Then why didn’t our clients receive margin calls? You are asking me instead of asking the bank. Why don’t you ask the bank?

Senator MASON—I am surprised you did not follow up. That was the point, Mr Cassimatis.

CHAIRMAN—Right now we are talking to you, though; we are not talking to the banks.

Mr Cassimatis—The answer is I do not know.

Senator MASON—What did you do when you found out they were not receiving calls?

Mr Cassimatis—I went straight to the bank and said, ‘Guys, there’s a problem here. You didn’t issue the calls. Contractually, you did not do what should have happened—

Senator WILLIAMS—Who did you say that to?

Mr Cassimatis—I first wrote to Mr Norris. In fact, on 31 October I had a meeting—and I do not have the names with me—with risk where I went and outlined to them and asked the question specifically—

Senator WILLIAMS—You said risk, meaning—

Mr Cassimatis—The bank, the highest level. I asked the question: ‘Guys, do you know something that we don’t know? I need to know if you do. Please tell me for the benefit of our clients.’ There was a resounding no—‘We don’t know anything that you don’t know.’ That was on 31 October. On 27 November, which was days after CBA pressed the button, I wrote to Mr Norris himself expressing concerns and asking the questions. That led to a meeting in Sydney on 1 December, which Mr Norris was going to attend. I got a phone call from Mr Tait, who said, ‘No, Mr Norris could not attend because he had to go to New Zealand for Westfield.’ But he had appointed a Mr Grimshaw to attend on his behalf who would then brief Mr Norris on our discussions.

I said to the bank at that time, ‘Do you understand what’s happened here?’ That led to a meeting on that day, on the first, being established on 4 December 2008. That was a Thursday where Storm people and CBA people were going to look at clients, with a view to coming up with a holistic solution—I used the term ‘holistic’ and it was agreed to—in order to look at the whole process. At the meeting on the first, Mr Grimshaw turned to Mr Tait, when I pointed out there was negative equity, because the data had caught up by then, and he said, ‘This isn’t supposed to happen.’ Mr Tait responded with something that I did not hear.

We had set up the meeting for the fourth specifically for the purpose of looking for holistic solutions for each client and there are documents to show that. On the third, I phoned Mr Tait to confirm that we were going down on the fourth, the next day. Based on the conversation I had had with him, I gained the impression that the CBA wanted us down there simply to help them sweep people’s accounts to fix the negative equity. I then immediately emailed Mr Grimshaw and said, ‘If it’s simply to do that, we’re not prepared to come down.’ He then emailed back and said he would be in contact with Mr Tait and that he fully understood the need for a holistic approach. Mr Tait did say to me on the phone that there was going to be no meeting with Mr Norris, which we had requested previously until all the clients’ negative equity had been swept up. And that is what prompted me to send the email to Mr Grimshaw.

We went down on the 4th. We allocated two days to look at every client account so that we could commence the solutions. By midday of that day it was quite clear to me, Carmela Richards and David McCullough that the people in that room had only one interest, and that was to sweep up the negative equity—nothing else. They did not want to look at the other things as promised. I then proposed a solution to Mr Tait at midday, who said, ‘You’ll need to put it in writing for our consideration,’ and we flew out, back to Townsville or Brisbane, wherever the case may be.

We got an email out that night. Mr Tait said Mr Grimshaw had the delegated authority to be able to give us an answer that evening. We did not get an answer that evening. He did contact us that evening to say, ‘Look, I’ll let you know tomorrow.’ The next day came, which was Friday, and we got an email which said: ‘The senior executive of the bank will need the weekend to consider your proposal.’ To me, that was good because they were considering it. I now know that they were not considering it, because we have since discovered scripts of the 5th and the 6th that were being established for a campaign to be launched on the Monday, the 8th, which it was. That campaign was launched by the CBA, and the rest is history.

CHAIRMAN—Mr Cassimatis, can you tell us whether you personally had a margin loan and who it was with?

Mr Cassimatis—I had a margin loan with CGI.

CHAIRMAN—So CGI was the provider of the margin loan, the margin facility?

Mr Cassimatis—Correct. It was about \$13 million, from memory.

CHAIRMAN—Did you get a margin call?

Mr Cassimatis—No.

CHAIRMAN—Obviously lots of things were happening, but as you realised things were not going—

Mr Cassimatis—Sorry—did I get a margin call? In 2002-03 I got probably 10 but, in 2008, none.

CHAIRMAN—You did not get a margin call this time around?

Mr Cassimatis—This time around, no.

CHAIRMAN—What did you do?

Mr Cassimatis—I simply allowed the process to occur and—

CHAIRMAN—Is that a sound strategy? If you have a \$13 million margin loan, you are comfortable just to allow the process to roll on?

Mr Cassimatis—Absolutely. I trusted that they would do what they had to do.

CHAIRMAN—Could you have met the full amount of your call?

Mr Cassimatis—Absolutely. Not only did we have one but Storm itself had a significant margin loan. In fact, I might add that CBA, the day before the directions hearing for the trial on the deceptive and misleading conduct stuff, issued us with a default notice using as an excuse Storm's own default in its margin loan. Storm could have easily met its own—

CHAIRMAN—You said earlier that keeping people informed was part of your process, and obviously 200 days is plenty of time to keep people informed, or educate them—you said you were educating them. Did you educate them? Did you explain to them the risks involved in your strategy? Did people understand what that meant, what the risk was?

Mr Cassimatis—There are two questions there: did we explain it to them? Yes, we did. Did they understand?

CHAIRMAN—So you explained to them they could lose their homes? You told them that? You said, 'You could lose your home'?

Mr Cassimatis—Yes.

CHAIRMAN—Were people ever concerned about their homes?

Mr Cassimatis—They were, overly concerned, yes.

CHAIRMAN—What would they do? Would they ask you or your advisers about their concern about their homes?

Mr Cassimatis—Well, we did not believe they were at risk. We did not believe that they would lose their homes.

CHAIRMAN—But your clients were concerned, though. We have read that in a number of submissions. They were concerned.

Mr Cassimatis—Yes, of course they were concerned, but at what time? Towards the end there.

CHAIRMAN—No, at varying points of time. Some told us they were concerned even at the peak of the market because it looked, in their words, 'too hot'.

Mr Cassimatis—Well—

CHAIRMAN—No, regardless—I am not going to get into hearsay. I am just asking: if your clients seemed concerned, why weren't you concerned? You were their adviser.

Mr Cassimatis—Because I trusted that the system that had always worked would continue working.

CHAIRMAN—So you trusted other people's money with somebody else's trust?

Mr Cassimatis—Of course. That is what you do.

CHAIRMAN—No documents, no legal contracts? I am just not sure—you based your trust on what? Normally we base our trust in documents. We sign a contract and understand exactly what happens at what point. You based your trust on what?

Mr Cassimatis—You trust an institution such as the CBA. If you cannot trust that type of institution, which institution can you trust?

CHAIRMAN—Sorry, since when have we been able to trust the banks? Just give me a date. Sorry, I should not have said that!

Mr Cassimatis—If I can answer the question: until about mid-November.

CHAIRMAN—Good answer.

Mr PEARCE—Can I ask a question, please. When did you first come to realise—

Mr Cassimatis—Sorry, Mr Ripoll, it is like trusting politicians. You trust them up to—

CHAIRMAN—Absolutely. Let me know when that happens for you as well.

Mr Cassimatis—Some you do; some you don't.

CHAIRMAN—We are all the same.

Mr Cassimatis—No, you are not all the same, just as all banks are not the same. Sorry, Mr Pearce.

Mr PEARCE—Thank you. When did you become aware that, to use your words, the system was not working properly?

Mr Cassimatis—Probably mid- to late November—probably.

Mr PEARCE—Did your business continue to receive any payments after that time?

Mr Cassimatis—I am not sure of the question. What do you mean by payments?

Mr PEARCE—Commissions or referrals for any other business.

Mr Cassimatis—Yes, of course. Commissions continue to be paid.

Mr PEARCE—You kept on getting the commissions, but you were aware that the system was not working?

Mr Cassimatis—I do not think it is that clear-cut. I was aware there were problems in the system, but I was aware there were problems in the world system. I think this tends to get forgotten. It is not a Storm-centric case; the whole world was coming apart.

Mr PEARCE—Did you detect any problems in your commission system or payments? Were there any problems in that area?

Mr Cassimatis—I do not know if you would call them problems. One of the things that happen when you go to cash is that the cash accounts do not carry commissions, so the commissions reduced when we went to cash, but that is not a reason to not go to cash.

Senator MASON—I have a general question. In fact, it follows on from Senator McLucas's questions earlier. We have heard a lot of evidence over the last week about the nature of financial advisers. One of the difficulties that many witnesses have spoken about is that, on the one hand, financial advisers sell products and they often get commissions, kickbacks and so forth for selling certain products. On the other hand, they are there to provide financial advice. In a sense, most people when they go to a financial adviser often think they are receiving independent financial advice, yet in fact what is actually happening is that that adviser is selling products. This is not a criticism of Storm; this is just a general policy question.

Mr Cassimatis—With which I agree.

Senator MASON—So do you think there should be a division between the provision of independent financial advice on the one hand and the selling of particular products on the other hand? Should people be called different names—

Mr Cassimatis—I do not think you will be able to do that because a doctor sells products in the form of drugs. He advises on—

Senator McLUCAS—No, they do not; they prescribe them, and then you go to a pharmacist.

Mr Cassimatis—And I said earlier that we took a prescriptive approach to what we did, so that is what has to happen. Advisers need to take a prescriptive approach. You did previously say to me that you had read our statement of advice. Did you read where we declare that we take a prescriptive approach?

Senator MASON—I just want to tie this down, because this is not just in relation to Storm. This is a general question. How as legislators can we change the law to ensure that people are not misled so that, when they go to see an accredited financial adviser, people know that they are receiving independent financial advice as opposed to consulting someone selling financial products? This is a question that keeps coming up. In every town we visit people talk about this.

Mr Cassimatis—Absolutely, and it is a question I had addressed many, many years ago. I do know that there are sections—

Senator MASON—What is your solution?

Mr Cassimatis—The solution is, literally, look at the medical profession. You need to take a prescriptive approach. All the training, all the directions for advisers need to be prescriptive. What is the problem? Here are the solutions, and there are pills out there that you can advise on. That is what we attempted to do. The adviser is just the final mouthpiece. The product flogging happens up here at the fund management level, at the institutional level. It is the concentration of the power within those institutions that drives that. So power corrupts and absolute power corrupts absolutely.

Senator McLUCAS—Mr Cassimatis, if you go to the doctor with a broken leg or a headache you will get a different prescription. What you are saying is that, if you turn up at Storm Financial, irrespective of your personal circumstances, the product you will sell these people is geared out leveraged finance?

Mr Cassimatis—That is correct.

Senator McLUCAS—So how in your system do you determine whether the person has a cold or a broken leg or a headache, because their personal circumstances vary enormously, but you only give them one answer?

Mr Cassimatis—That is correct. If you go to a general practitioner you will get a different prescription. If you go to podiatrist you will get the same prescription.

Senator McLUCAS—No, it is not the specialist; it is the individual who is different. That is the difference.

Mr Cassimatis—We were specialists that selected the people that had the same condition. I said one in four were Storm clients. Three out of four were not Storm clients.

Senator McLUCAS—But you agree that they were self selectors? It was not on the basis of the advice that was being provided in a holistic sense; they were self selecting into one product?

Mr Cassimatis—They were self selecting, but we also viewed them and scrutinised them to make sure that they belonged there. That was our view.

Senator McLUCAS—You said that only on the odd occasion did you decline clients.

Mr Cassimatis—Yes, it was not often, but we did.

Mr ROBERT—Mr Cassimatis, following the medical analogy, you said that you selected people with the same condition. There are 70-year-old pensioners who lost their homes that your advisers leveraged into growth products. How can you possibly say that a business professional in their 30s or 40s or a baby boomer with \$5 million worth of super and a 70-year-old pensioner all have the same symptom? That is just gross nonsense and flies in the face of anything that is possibly acceptable. How has a pensioner got the same condition as a \$5 million independent superannuant?

Mr Cassimatis—There are individuals who were not superannuants and who were not 70 who are in danger of losing their homes. So the position is not the age; the position is: ‘Why would you disadvantage someone because they are 70, if that is what they wanted to do?’.

Mr ROBERT—You told Senator McLucas that they were in the same position.

Mr Cassimatis—Correct.

Mr ROBERT—A 70-year-old pensioner putting their house on the line onto leveraged funds is nothing even remotely the same as an independent superannuant.

Mr Cassimatis—Why would you not want to give the same opportunity to anyone at any time? This was not about the extent of the debt. That is what keeps getting focused on. This is about the ability of the asset to service the debt. If a 70-year-old purchases a block of units that question would not get asked. It is not a different process; it is the same process. Accordingly, it is about the destruction of the asset. The debt only became a burden when the asset got destroyed—and, along with the asset, all these people’s lifestyles.

CHAIRMAN—Who destroyed the asset?

Mr Cassimatis—I believe the destruction of the asset first was the global financial crisis and then the residual for everyone, because everyone had assets destroyed—there was not one of us who did not in the normal course of events. But it is about all of the asset being destroyed.

CHAIRMAN—How close to the tipping edge was that asset at all times?

Mr Cassimatis—It was generally a long way away from that tipping edge. When you get a 30 per cent fall followed by a 30 per cent fall, you have a major issue.

Senator MASON—I will again bounce off Senator McLucas because she asked very interesting questions about disclosure in the statement of advice. This is a general question. We have heard evidence throughout the country about it. How long was Storm’s statement of advice?

Mr Cassimatis—One-hundred-odd pages.

Senator MASON—We have heard evidence over the last week and a half about statement of advice documents that, in a sense, qualify as disclosure of commissions, upfront costs and so forth. We heard that many people simply do not understand hundred-page documents. It is true that they will sign them. They often sign every page. But they do not understand it. Do you think it would be better to summarise a hundred pages in a page or two in, as Senator Williams’s words, ‘shearer’s language’?

Senator WILLIAMS—Except without the swear words!

Senator MASON—Do you think that would be a better way and that disclosure would actually equal transparency?

Mr Cassimatis—It would be a better way if it could be done, but it cannot be done, especially when you have regulations that require certain levels of disclosure. Which one are you going to leave out? Which one are you going to highlight? Which one are you going to put in bold print? Which one are you going to—

Senator MASON—You do not think you could summarise in a couple of pages?

Mr Cassimatis—No.

Senator MASON—Other people have given different evidence, but you do not think it is possible.

Mr Cassimatis—I do not think it is possible. The way we tried to handle it was to make it compulsory for everyone to do a workshop. We also knew that not everyone was going to fully understand the stuff in the workshop.

Senator MASON—But wouldn't you accept that many people would not understand the hundred-page document?

Mr Cassimatis—Yes, of course—on its own. More people would understand it if you put it in the context of the education process, but still not everyone would understand it.

CHAIRMAN—You said before that power corrupts. Who would you say holds the power in the relationship between the adviser and the client?

Mr Cassimatis—It depends on the client. I would need the question to be clarified a bit more. In what circumstance?

CHAIRMAN—Generally. If power corrupts—you made the statement about power, the concentration of power and all these people having power. In the simple relationship between the adviser and the client, who holds the power?

Mr Cassimatis—On balance, probably the adviser holds more power, because of the knowledge base. But in the case of a bank, for instance, the contractual power is enormous and diabolical. It is not something that a client can wiggle out of.

CHAIRMAN—In Storm's case, were the clients the decision makers? Were they the ones asking for margin loans and more debt? Were they controlling their destinies?

Mr Cassimatis—Very few of us do. Storm made recommendations, they were accepted and to the best of our ability we tried to guide them through. In the end, though, the train came off the rails quite heavily.

CHAIRMAN—Did you have professional indemnity insurance for your organisation?

Mr Cassimatis—Yes.

CHAIRMAN—How much?

Mr Cassimatis—I do not think we can disclose that.

CHAIRMAN—It should be well known to everybody; it is public information.

Mr Cassimatis—Forty million dollars.

CHAIRMAN—Did you ever apply for professional indemnity insurance and not have your application accepted, have it refused or have it not followed through?

Mr Cassimatis—I do not know. I would guess not.

CHAIRMAN—It is a pretty big thing. If you are applying for insurance, you would know who your insurer was and if they accepted or did not accept. In these education forums that you had with people, during the 200 days, two or three sessions or seminars—whatever you want to call them—did you ever talk about insurance cover and how people were safe because you had insurance cover?

Mr Cassimatis—As a general rule we would not but it may have got mentioned on occasions.

CHAIRMAN—So that would never have been mentioned?

Mr Cassimatis—I did not say that. I said that as a general rule it was not part of the education forum. I don't think there is a slide on it—

CHAIRMAN—You have said—and correct me if I am wrong—that you sold a product but the product failed.

Mr Cassimatis—Sorry?

CHAIRMAN—I understand from what you are saying that you were selling a product and that the product failed the people who invested—that it was the collapse of the product. Is that not the case?

Mr Cassimatis—An element of the product failed.

CHAIRMAN—So you would not say that your strategy failed in any way? You are saying that your strategy is still sound and would still work under any conditions in the market—that it is just a bad product, not bad advice.

Mr Cassimatis—No, I would not say that.

CHAIRMAN—You would not say that?

Mr Cassimatis—I would not say that it would work under every condition. Nothing works under every condition. Is it possible to foresee everything? I do not think so.

CHAIRMAN—How would you define what you did? Did you sell products or did you sell advice?

Mr Cassimatis—Our advice was commoditised, so we sold product in the form of advice.

CHAIRMAN—You used the analogy of going to a podiatrist. How clear was it to people what you were?

Mr Cassimatis—I think it was very clear that we were specialists in leveraging. I think that everyone knew that leveraging was used and that that was the way that we enhanced people's wealth over the decades.

CHAIRMAN—Would you say that you provided independent advice or that you were tied to product?

Mr Cassimatis—Well, independent is a technical term, isn't it?

CHAIRMAN—It is pretty clear to me what it is.

Mr Cassimatis—You are asking if I would say that I provided independent advice. Please define 'independent'.

Senator MASON—Not beholden to anyone.

CHAIRMAN—No conflict of interest.

Mr Cassimatis—Not beholden to anyone? Well, no. It was not independent.

CHAIRMAN—You said earlier that 'they' had a panic moment. I am assuming you meant the banks?

Mr Cassimatis—Yes.

CHAIRMAN—Why did they panic?

Mr Cassimatis—I think the data finally caught up—the data that was, particularly in October and November, profoundly wrong.

CHAIRMAN—Why did it only catch up for your Storm-badged index fund? Why did it not catch up for other funds? What is the point of difference?

Mr Cassimatis—The suspension of the funds, I believe.

CHAIRMAN—But why were the funds suspended?

Mr Cassimatis—Because of the level of redemptions.

CHAIRMAN—And why were people being redeemed?

Mr Cassimatis—Because we were taking them to cash.

CHAIRMAN—And why were you taking them to cash?

Mr Cassimatis—Because we saw the federal secretary of the Treasury in the United States on his knees begging Congress to approve a rescue package and at that point we thought, ‘Gee, there could be more to this than we initially thought.’

CHAIRMAN—And you believed that that strategy was the appropriate strategy for every single one of your clients?

Mr Cassimatis—Getting out the cash, yes.

CHAIRMAN—And you advised them as such and followed through on your strategy?

Mr Cassimatis—We attempted to.

CHAIRMAN—Did you believe that at any moment Storm lost control of its own strategy or that you were no longer in control of what you were doing?

Mr Cassimatis—I feel it now.

CHAIRMAN—I know we have gone over this a couple of times and I will only ask it one more time in a general sense, but in 2003 margin calls were made. Who was managing portfolios in margin calls? Who was managing that interaction between Storm and the lenders?

Mr Cassimatis—CGI was managing that.

CHAIRMAN—Independent of you. What were you getting paid for? What were you doing?

Mr Cassimatis—The advice. We were looking at the advice. We were there to provide the solutions when clients came back to us. They got the margin call; that was our way to make sure clients got margin calls. We did not want to intervene and have the risk of information not getting to the clients, so the margin call information went directly from bank to client, as it continues to do today. The information still goes directly to clients. They still get statements directly from CGI, even now, showing zero, zero, zero.

CHAIRMAN—Why couldn’t you get enough institutional investors and underwriters for your public listing?

Mr Cassimatis—I have pondered this at some length. I cannot be certain, but I think there are two answers to that. One was that when we went to float the subprime crisis had hit. I think they knew something, but I do not want to be too conspiratorial about that. The other thing was that I think our model did not have sufficient weight on trails for future income streams, did not have sufficient emphasis on trailing commissions, so it was difficult for their analysts as they like the trails.

CHAIRMAN—Would you do it all again?

Mr Cassimatis—Do what all again?

CHAIRMAN—The whole thing. What have you learned?

Mr Cassimatis—With the lessons I have learned I would love to do it all again and fix all the things that I think need fixing.

CHAIRMAN—Thank you very much. We do appreciate your time, openness and frankness.

Mr Cassimatis—Would I be able to make one comment?

CHAIRMAN—Please do.

Mr Cassimatis—I want to put on the record that I noticed that you said to me that you did not want to go into evidence at all, but I noticed that Senator Mason said you had heard a lot of evidence.

CHAIRMAN—Everything you have said today is evidence.

Mr Cassimatis—There is a lot of evidence here that I have not been able to get out and disclose.

CHAIRMAN—If you want, you can send it to the committee secretariat.

Mr Cassimatis—No.

Senator MASON—There were many issues we did not traverse because they are not relevant to our inquiry. They are for another time and another place.

Mr Cassimatis—Without looking at it you cannot know to determine whether it is relevant.

CHAIRMAN—I do not want to be rude and cut you off at this point, but we are not having a negotiation.

Mr Cassimatis—I understand that.

CHAIRMAN—We are having a public hearing. We really do thank you for your time. You have been generous. We have gone over time and we acknowledge that. We appreciate your openness and frankness in appearing before us today.

Proceedings suspended from 11.07 am to 11.27 am

[11.27 am]

FORSYTH, Mr Jolyon, President, Australian Investors Association

McKENZIE, Mr Scott, Vice-President, Australian Investors Association

CHAIRMAN—Welcome. Would you like to make some opening remarks?

Mr Forsyth—We appreciate the opportunity to speak before this inquiry on behalf of thousands of independent investors, many of whom are our members, and on behalf of investors who, although not members, have told us their tales of woe or we read their stories in the press. We have thought for years that the financial services industry has many disgraceful aspects. We regret that it took some multi-million-dollar losses of mum and dad investors for these disgraceful aspects to become obvious to everyone.

The root of the problem is human greed, affecting the investor and the adviser. We believe that the fundamental matter to be resolved is that advice must be objective, appropriate and free of conflict of interest. I think we are all well aware of the fact that if I were to go to a financial planner with, say, an inheritance of half a million dollars, the most likely advice I would get would be to put it into managed funds or possibly Australian shares, with little or any consideration being given as to whether a better use of the funds might be to pay off the mortgage, contribute to an industry super fund, pay off other debts, and so on. The advice I would receive would be to do something that led to a commission payment to the adviser—not all advisers but a huge percentage of them. The AIA sees such an industry as being about selling rather than advising.

Our submission asks that you: (a) remove inherent conflicts of interest at present in the industry; (b) separate the sales and advice functions; (c) raise the low educational level that was required of advisers; (d) address the illusion of independence of advisory firms connected with banks and insurance companies; (e) provide simple investment risk signals for consumers; (f) require payment for services to be initiated by the client, not the investment product provider; (g) require clients to have more control over the investment advisory process; (h) promote investment education among consumers; and (i) provide for better regulation and enforcement within financial services.

I remind the committee of the case of the pensioner widow reported in the *Australian* on Monday morning who signed a blank margin loan application form that someone else filled in for a \$208,000 additional loan. This was added to her existing \$625,000 margin loan. The form stated that she earned \$104,000 per month, even though she was in fact a pensioner. She now faces the loss of her home. So we present ourselves here today to reflect the point of view of investors, many of whom have lost confidence in the financial planning and advisory industry.

CHAIRMAN—I am sure you have read submissions and heard witnesses and heard all sorts of tragic tales of people's circumstances. In the simplest terms, what do you think is at the core of the problem? We will leave regulation aside for the moment. Where do you think the problem stems from?

Mr Forsyth—The core of the problem, in our opinion, is the fact that too many of these people are remunerated by commission, which tends to be provided by the people who provide the investment. Any advice that I get is not paid for in most cases by me; it is paid for by the person from the managed funds or whoever it happens to be who is providing the investment.

CHAIRMAN—But that is a pretty general statement. That does not cover the vast majority of different circumstances. As we have heard from Storm, for example, people charged a very large upfront fee and claimed they had no commissions. How do you balance that? Is just the remuneration of the problem or were there other incentives?

Mr McKenzie—I believe that another way of looking at the root problem is the need to separate advice giving from sales. I think that is the fundamental problem that exists. We ought to have a structure of advice giving—say, registered financial advisers who are professionals, as I have seen suggested in some of the submissions that have been made to this inquiry. They would give advice quite separately from the investment salespeople or investment advisers who in fact sell products. Just as when I go to a doctor I get advice and I take it to a chemist and get a prescription filled, can we not have the same thing happening here in the financial services industry? Separating sales from advice—I think that is fundamental.

CHAIRMAN—How do you practically do that?

Mr McKenzie—It is really hard, I agree. It is not easy to do because we have a history in this country of 20 or 30 years of moving from stockbroking salespeople, insurance agents and salespeople and we have come through and the profession has tried to make itself a profession and so any change is going to be hard going. But I think it can be done with the notion of a registered financial adviser around whom legislation and regulations are set up and such a person has this function and this fiduciary responsibility and charges fee-for-service.

CHAIRMAN—Do you think that is more important than perhaps distinguishing between classes of investment that are more sophisticated or, let us say, risky and other types of investments that are less risky? Which one is more important? Do we go down a path of trying to define who is so-called advising and who is so-called selling compared to the different products that exist in the market?

Mr McKenzie—The emphasis now is on the investor and wanting to distinguish the sorts of investors. I can imagine that that is a simpler thing to do. I am not sure that it is fair. I am not sure that it will work. Fundamentally, if we want to create a profession of financial advisers then we have to do what it takes to create a profession. I have no problem with people selling products, just so long as they do not pretend to give advice at the same time.

CHAIRMAN—If that is the case, are there good products and bad products? Are all products good products and it is who you sell them to that makes the difference rather than the other way around?

Mr Forsyth—I think there is a degree of risk that comes with all of the products. The Storm Financial situation was predicated on the fact that the market was going to keep going up and up. As we have seen, the market did not do that. That was not the first time: go back to 1987, when the market dropped 50 per cent in a couple of days. These are risks, and investment in the stock

exchange certainly carries a lot more risk. I think it is the risk that one has to look at. ASIC is suggesting much the same thing with their 'between the flags' approach. We think there should be stuff outside the flags and stuff way outside the flags, as well, so that people are alerted to the risk. I do not think that it is the product itself that is essentially bad; I think it is the degree of risk associated with the product.

CHAIRMAN—We hear a lot about graphs and averaging. People have risk explained in seminars and education sessions. They are sort of told, 'Over the length of the market and from the data we have got in the last 100 years, if you average it all out the line starts here and ends up here, in a straight line.' Does that really do any justice to informing investors about risks or about the chances they are taking with their life savings?

Mr Forsyth—I do not think that is alerting them to the risk. I think it has to be pointed out that in 1987 and 2008 this is what happened. I believe a competent adviser would do that.

CHAIRMAN—I asked a question earlier, in another session, about the power imbalance. In your experience where does all the power sit in the relationship between an adviser and the client?

Mr McKenzie—With the adviser.

CHAIRMAN—It is with the adviser.

Mr McKenzie—And I agree with a couple of the submissions that say one of the things we should be on about is finding ways to empower the consumer in this.

Mr Forsyth—The investor.

Mr McKenzie—Yes, we should empower the investor.

CHAIRMAN—Why has the adviser got so much power?

Mr McKenzie—Well, there is an information power, for a start, that the adviser has. I must be upfront; I am an adviser.

CHAIRMAN—We will not hold that against you; it is all right.

Mr McKenzie—And I do not hold it against myself. I have seen it happen. I had someone walk into my office yesterday. She sat down and talked with me and accorded me all the power in the relationship. I had to do whatever I could to empower her to ask. I told her some of the things that maybe she should have asked questions about. I could see that because she did not understand what we were talking about, despite my best efforts—

CHAIRMAN—So it is really up to your integrity. It is up to your standards.

Mr McKenzie—Absolutely.

CHAIRMAN—It is very personal.

Mr McKenzie—Absolutely.

CHAIRMAN—Just to explain that power a little bit further, it is not just a relationship power. Is it a contractual power in terms of people signing over authority to superannuation, authority over shares and mortgages?

Mr McKenzie—They might do that but I would never accept that. That is crazy.

CHAIRMAN—No, you would not but—

Mr McKenzie—When I go to a builder and I say, ‘I want you to build me a house,’ I do not just leave a blank cheque there and say, ‘Tell me when it’s finished,’ and fill in the cheque. That is the other extreme, isn’t it, of this sort of thing? We have to accept that when somebody comes to an adviser with half a million dollars, they are 65 and they have 25-odd years of life left—and that half a million has to last that time—they are making a huge commitment. They are trusting someone or they are looking for details that will convince them that what they are hearing makes sense. The adviser has to be the sort of person, I believe, who will recognise the huge fiduciary responsibility that is accorded him.

CHAIRMAN—Do they actually have a fiduciary responsibility?

Mr McKenzie—I do not believe so, according to the legislation. I think that is one of the things we might fix up!

Senator MASON—I will touch on both the issues the chairman has raised because they are both central. I do not come from a finance background at all, but one of the things that has interested me over the last week and a half, whilst hearing the testimony of many people who have been very seriously affected by the global financial crisis and by advice that they received, is that people often spend weeks searching for a home and deciding upon their new house, certainly days looking for a new car and hours looking for the new CD player, yet they will instantly hand over the power to someone else to spend half a million dollars. That has struck me over the last few days that people’s life savings can be given to someone and with the stroke of a pen—you look after it. It is an enormous trust, isn’t it, to financial advisers? Yet as you say quite rightly there is not a fiduciary duty at all. In relation to designing a better professional platform for financial advisers, you mentioned you could divide it into people who sell product—and there is nothing wrong with that—or giving independent financial advice, if someone is giving independent financial advice you say they should be fee-for-service and they should be subject to a fiduciary duty; is that right?

Mr McKenzie—Absolutely, yes.

Senator MASON—And if you are selling a product they get a commission based payment; is that right?

Mr McKenzie—If the separation is 100 per cent.

Senator MASON—Assuming the separation is clear, is that right? And the duty would not be as fiduciary as the current duty is at the moment, that is, do the right thing by your client?

Mr Forsyth—I would still have reservations about the commission on that simply because of the tendency. We have seen it before if you go back to Westpoint, and back to the 1980s with Rothwells. There was the same sort of thing there because people were being paid a much greater than usual commission.

Senator MASON—The committee will recognise we are going back to where we started early last week. In other words, commissions in a sense nearly operate as an inherent conflict of interest; is that your point?

Mr Forsyth—Yes.

Senator MASON—Thank you.

Senator McLUCAS—Can I go back to what you were saying is the root cause of the problem which is the need for separation between a fee-for-service advice model and products on shelves being sold at another place. The Financial Planners Association gave us evidence, which you may have seen, saying that they are moving towards that as a preferred system. They identified a number of problems with existing relationships that may have to be grandfathered or something like that, for example. I would like your comments on what do you do with existing relationships between investors and advisers. It was not from financial planners but it was on the same day of evidence. We were alerted to the fact that, if you do a separation like that and separate out advice and product, you potentially run the risk of the advice being a seemingly expensive piece of work that low- and middle-income families and people who potentially have the most need for good advice will be priced out of the market. It is a dilemma for me and I would seek your input.

Mr McKenzie—I think it is overstated, frankly, and I think it is the downside of the Financial Services Reform Act that concentrated on the form rather than the substance of advice. As a result of the FSRA, advisers feel they have to construct 80- to 120-page statements of advice. You know as well as I do that 95 per cent of the words are already in the computer. It is just an absurdity that a few extra words and numbers are typed in and out comes a 120-page report that is meaningless to most clients.

My belief is this: if somebody comes to me with a \$50,000 inheritance I can, in half an hour, figure out the best thing for them to do with the money, write them a letter of a page and a half that advises them about that and maybe bill them \$150, not give them a \$3,000 statement of advice, which is an absurdity. I think the industry has been propelled in the direction of these big statements of advice because of the FSRA, the Financial Services Reform Act.

Senator McLUCAS—You would be aware of the work that is currently underway to come up with a one- or two-page summary document?

Mr McKenzie—Yes.

Senator McLUCAS—You would support a move in that direction?

Mr McKenzie—I have done it. That is what I do.

Senator McLUCAS—Do you also complete another statement of advice that you give to people to put on their shelf, to cover yourself legally?

Mr McKenzie—No, because I have a series of meetings with people and we progress through stages. I just document the stages we go through. It is fortunate that most of that was some years ago. I am semiretired.

Senator McLUCAS—Is another way to skin this problematic cat to improve the disclosure of trailing commissions or fees in general? Is it possible to get to a point where disclosure systems are well understood by the investor and can be relied upon and not abused by more unscrupulous individuals? Is disclosure an answer to the problem?

Mr McKenzie—No.

Senator McLUCAS—Unequivocally?

Mr McKenzie—It has not worked so far, has it?

Senator McLUCAS—I suppose my question is: have we got disclosure right and, if we got it right, could it be the answer?

Mr McKenzie—We have had four or five years to try to get it right and that has not worked. I can tell you that the layers of fees that exist between the investor and the product manufacturer via the licensee are so many that, even if you disclosed them, all the client would be is shocked; he would not understand it. I am talking about shelf fees and all manner of fees that you would come across. I do not think disclosure is the answer. I think fiduciary responsibility is the answer.

Senator McLUCAS—Coming to fiduciary responsibility: have you had an opportunity to read the submission from SICAG?

Mr McKenzie—No.

Senator McLUCAS—Then I will not ask the question. The other question I have is: what do we do about improving financial literacy in this country?

Mr Forsyth—That goes back to the education system. I think it is really something that the Minister for Education should be looking at very hard in terms of what we do overall. We started off with compulsory superannuation, and it is going to get bigger and bigger. Under those circumstances, the only place you are going to do it is in schools. That is where we need to have the school curriculum changed to include some lessons on financial literacy.

Senator McLUCAS—Mr Forsyth, I am a former schoolteacher. Whenever anything is wrong in society, we tell our schools to teach more. Can I put to you that if you sat in front of a 16- or 17-year-old person and talked about margin lending or what nine per cent of their superannuation might turn into when they turned 82, that 16-year-old person would not be paying attention. I think we probably have to look at a whole-of-life education event. Who knows what the 16-year-olds of today are going to be dealing with when they are coming

towards their retirement? I would be interested in any comments that your association has about whole-of-life education. It is something we need to do on an ongoing basis, but the way to make people interested in these difficult and complex financial matters is something that I think we are struggling with.

Mr McKenzie—I am an ex-teacher too, Senator.

Senator McLUCAS—We tend to defend our profession, don't we?

Mr McKenzie—Yes. I have got involved with developing curriculum at a state level and I understand the notion of putting stuff into the curriculum. It is overcrowded already. I do not think the answer is there at all, unless one makes a huge change to the education system and makes it education for life rather than for employment, but that is another matter. I think Senator Mason has it right—there is a cultural problem here. We have to acknowledge the fact that people come to a financial advisor from a totally disempowered perspective and that it is down to the professional across the other side of the table to acknowledge that and to respond appropriately, knowing that he has a fiduciary responsibility—that is the enforcement bit. If we can take a 20-year perspective on that and develop down that trail, I think we will have the beginnings of a solution to this problem; otherwise, I believe it will be terribly difficult. That is all I will say, other than giving a plug for the Australian Investors Association, where you will get all the knowledge you need to deal with that fella cross the table.

Mr ROBERT—Gentlemen, I am not a teacher. I have a business background. How many members does the Australian Investors Association have?

Mr Forsyth—About 2,000.

Mr ROBERT—And how long has the association been going for?

Mr Forsyth—It was founded by Austin Donnelly, and I am not sure whether that was in the late 1980s or the early 1990s. We were talking about it earlier this morning and I did not get the answer, I am afraid.

Mr ROBERT—Who are your competitors in the market in terms of association, advice and so on?

Mr Forsyth—There is the Australian Shareholders Association, but we tend focus far more on education. Our motto is 'Investors Helping Investors'. I believe the Australian Shareholders Association tend to be far more interested in getting their people to go to annual general meetings and getting their members to give them their proxies and to raise questions at board level on that. I believe we are much broader in that we cover not just shares but property, managed funds and superannuation—the whole lot.

Mr ROBERT—What percentage of your members have been impacted by the spectacular collapses of Storm, Opes Prime and others?

Mr McKenzie—We did a survey of this and only one member put his hand up as being affected by the Storm situation.

Mr Forsyth—We sent a survey via email to everybody for whom we have an email address, which is the vast majority of our members, and we have been getting a response rate of about 25 per cent, which I think is pretty good compared to most other surveys.

Mr ROBERT—Let's just say one member, or a minimal number, had exposure to the Storms and Opus Primes—why do you think, out of 2,000 members, only one decided to invest in Storm and other areas?

Mr McKenzie—They understand risk. We talk about risk, we look at what has happened in markets over 100 years and we have material going all the time that suggests that right now our market is vastly undervalued, but we also have material going out that says there could be a big correction, starting yesterday.

Mr ROBERT—Can I take it, from the statement that your members understand risk, that you believe that the Storms and the Opes Primes—in this case, Storm—did not manage risk well?

Mr Forsyth—They were going into a policy of double-gearing. You were borrowing money on your house and then getting a margin loan on top of that. The risk associated with that has to be extremely high.

Mr ROBERT—Mr Cassimatis, when the committee asked him questions as to who was responsible, laid the responsibility clearly and squarely at the feet of the banks. Do you have a comment in that respect?

Mr McKenzie—That is ridiculous. Who is the advisor? Who is sitting there suggesting strategies for wealth creation, for whatever purpose?

Mr ROBERT—I am just cognisant that, as two executives in the association, you are the largest representative of investors across the broad spectrum—hence my question as to who else you are in competition with in that respect. When I asked Mr Cassimatis why he did not know that margin calls were coming in—he knew his investors had a loan-to-value ratio approaching 90 per cent and he knew the market had dropped by 50 per cent—his response was that the banks' systems were not up to date and he was not informed. Is that a responsible thing for an investor to do—just wait for the banks, knowing full well what their clients' position is?

Mr McKenzie—Is this privileged?

Mr ROBERT—It is.

Mr McKenzie—That is the most nonsensical thing I have heard for a long, long time. With an LVR of 90 per cent and a market heading downwards rapidly, it is nonsensical to suggest that one, having set up that situation with clients, is not actively managing the process.

Mr ROBERT—We took an enormous amount of evidence from a range of affected people who indicated that there was constant pressure to put more money into Storm products; indeed, there was some evidence where people said, 'I actually hid money so Storm wouldn't know I had it,' which I find staggering in itself. Your submission, No. 5, says:

There is a culture of ‘selling’ pervading much of the financial advisory services industry that pretends to be ‘professional service providing’. It is crucial that we find a way of separating these two functions.

How do you recommend separating those two functions?

Mr McKenzie—As I indicated before, I think the starting point is to create a class of professionals called ‘registered financial planners’ or ‘registered financial advisors’, who charge a fee and have a fiduciary responsibility. The product of their work would be a statement of advice, and then someone else would have the task of implementing that. This is simplistic, I know, and there are a lot of things to be worked out, but, just as I take a prescription from my doctor to my chemist and get it filled, so one might take a statement of advice about investment from an advisor to an investment consultant or salesman and get it filled.

Mr Forsyth—When you go to the chemist, the chemist will ask you, ‘Do you want the specific product written on the prescription or a generic equivalent?’ So the person who is providing the investment products can not necessarily say, ‘You’re going to put this money into BHP’, ‘You’re going to put it into Rio Tinto,’ or, ‘You’re going to put it in that managed fund.’ There will be options there. That is why I do not like a commission being paid at that point in time—because the tendency of the person providing the product is going to be to push people into those that are going to pay them the highest commission.

Mr ROBERT—What do you believe is the minimum qualification a professional in the financial services industry—that is, a provider of advice—should have?

Mr McKenzie—A bachelor’s degree in financial services.

Mr ROBERT—You believe that is the absolute minimum?

Mr McKenzie—Absolutely.

Mr ROBERT—We took advice in the MIS inquiry about providers of MIS who had done a nine-day course and were then qualified to provide advice into MIS. Do you believe that is too short?

Mr McKenzie—If the person who has done the nine-day course is just selling and explaining the features of one particular product, I have no problem. But, if they are dealing with somebody who walks in off the street and says, ‘I’ve got a quarter of a million dollars here and I don’t know what to do with it,’ that is obviously a problem. We are talking about the last 20 to 30 years of someone’s life. For that sort of money to go into the hands of someone who is flogging products is criminal. I know it really is hard, but this is such a serious matter that we should begin at the beginning and say, ‘Let’s set aside a class of people who, by virtue of education, experience, personal characteristics—

Senator MASON—And legal duty.

Mr McKenzie—and fiduciary responsibility hanging over them, are the people we are going to trust to give advice about how people use their money.

Mr ROBERT—If that were the case, do you believe that that class of professional should charge commissions or up-front fees for their advice?

Mr McKenzie—No—an hourly rate, like other professionals.

Mr ROBERT—Like an accountant or a lawyer, heaven forbid!

Mr McKenzie—That is right—or a doctor.

Mr ROBERT—Is there a place for the nine-day product selling wonder?

Mr McKenzie—Yes, if he is selling one particular product that has very few characteristics.

Mr PEARCE—I thank you both of being here this morning and for taking the time to chat with us. At the end of the day, our job is to come up with a report that looks at the issues in and around some of the collapses and make recommendations about how the law may be changed. I would like to ask you a series of questions as the devil's advocate, if you like; I want to quiz you, if you like. I am not divulging any particular position, in my way of thinking. You have spoken a lot about the idea of having a fiduciary duty. Mr McKenzie in particular, I am interested to know: if you woke up tomorrow and you had fiduciary duty, what difference would it make to you?

Mr McKenzie—Personally, I do not think it would make any, because I have always regarded myself as being under fiduciary duty for whichever clients I deal with in whatever financial circumstances.

Mr PEARCE—What difference would it make to the industry?

Mr McKenzie—We operate at the moment on the basis of: know your client, know your product. That is just not strong enough, really. Fiduciary duty means that I have to be able to demonstrate that any advice I give is in the best interests of the client.

Mr PEARCE—How long have you been in the advisory business?

Mr McKenzie—About 10 years.

Mr PEARCE—So you are experienced. In your experience, what practical difference do you think it will make? Is every adviser in Australia going to wake up the next day and say, 'I've got to change the way I do my job'?

Mr McKenzie—I really cannot speak for them. I can speak for the people who work for Storm, Opes Prime and so on. Obviously something went wrong there.

Mr PEARCE—Do you think that they would wake up the next morning and do their job differently?

Mr McKenzie—They would not go to work!

Mr PEARCE—So, in other words, you cannot tell me that you think it would make a big difference?

Mr McKenzie—It would make a huge difference.

Mr PEARCE—I have asked you: how would it make a difference?

Mr McKenzie—Everybody would have to think—to make our first point: what is the best action for this person in this circumstance?

Mr PEARCE—And everybody would, if that became the law?

Mr McKenzie—If the alternative were being sued and having to defend one's position—absolutely.

Senator MASON—You could focus the mind.

Mr McKenzie—There is nothing like law enforcement to do that.

Mr PEARCE—Let's go back to the comments you made about the core problem: the need to separate advice from product sales. Mr McKenzie, I think you said something like: 'Disclosure hasn't worked.' You have been an adviser for 10 years. Have you sold product to people throughout those 10 years?

Mr McKenzie—I would not have used those words, Senator.

Mr PEARCE—I am not a senator; I am from the House of Representatives. Please don't call me a senator!

Mr McKenzie—What I do, and what I believe quite a significant number of my colleagues do, is look at the financial situation of the person presenting—

Mr PEARCE—Yes, but my question was: have you sold product?

Mr McKenzie—I recommend to them that they invest their money in a certain place, which you are calling a product.

Mr PEARCE—Have you received commissions as a result of selling those products?

Mr McKenzie—I have indeed.

Mr PEARCE—And you disclosed that?

Mr McKenzie—Yes.

Mr PEARCE—But now you are telling me that that has not worked for your clients.

Mr McKenzie—I did not say that at all. Perhaps I ought to say that I am here as a representative of the Australian Investors Association, not as a financial adviser. I am quite prepared to defend the way I behave.

Mr PEARCE—I am not asking you to defend it. Remember, I am asking you as the devil's advocate. You said disclosure clearly has not worked. However, it has worked for you and your clients, hasn't it?

Mr McKenzie—I would have thought so, and I am sure it works in some circumstances/

Mr PEARCE—You said disclosure has not worked, but now you are saying that disclosure has worked in some circumstances. Are you prepared to say that it has worked in some circumstances?

Mr McKenzie—Yes. For example, anybody who deals with me knows exactly the firm that I am a director of. It is a small, tiny, little firm. But somebody who goes into a certain named advisory firm does not perhaps realise that it is owned by a certain big bank or big insurance company.

Mr PEARCE—I understand. I think what you are saying to me is that you pride yourself—by the sound of it—on ensuring your client is fully abreast of all of the circumstances, all of the arrangements and so forth?

Mr McKenzie—Yes.

Mr PEARCE—So you have completely disclosed everything?

Mr McKenzie—Yes.

Mr PEARCE—And that has worked.

Mr McKenzie—I believe so.

Mr PEARCE—So, to get back to what you see as the core problem: in your particular experience, that has not been a problem, because it has worked. True or not?

Mr McKenzie—Yes.

Mr PEARCE—This is the issue for us. This really comes to the nub of the problem. When you are talking about the system, do you think there is something wrong with the system or is there something wrong with the way people have promoted the system? They are two different things, aren't they? In your case, you are telling us that the way that you have worked with the system and promoted it has worked for you and your clients. So, therefore, by definition, the system is not broken. Is that fair?

Mr McKenzie—I am not quite sure how to answer that. I do not think one case, two cases or 10 cases make a general principle. More to the point, we have seen in the last 18 months in

Australia a whole lot of people let down very badly because, fundamentally, they were dealt with by salespeople, who are paid by commission.

Mr PEARCE—That is my point. Is that the fault of the system or is that the fault of the fact that they work like you—because you have played in the same system? That comes back to this issue about the core problem, does it not? This is the challenge that we have as legislators. We have to come up with a series of recommendations which will affect the law in relation to how we can ensure that all of us—all of our friends and our family and everybody else in Australia—are protected.

CHAIRMAN—Mr McKenzie, in your experience, if we were to change some regulations and place more fiduciary responsibility or other responsibility on individual advisers, do you think that would change their behaviour?

Mr McKenzie—Absolutely.

Mr PEARCE—He answered that before. I will go back to the core problem. What you are saying is that disclosure has worked in some cases but not in other cases. If the law was tighter or stronger in the area of disclosure and transparency, do you think that would improve protection?

Mr McKenzie—It might. I am not proud of what I have had to say about the way I operate a business. I am talking about a dozen clients, and I have struggled for some years about the fact that I ought to change the way I operate. But the alternative is a difficult one. I am very uncomfortable with us generalising on the basis of a tiny, little bit of experience that I have had—that I am not happy with actually.

Mr PEARCE—Do you think that your members would like to see a strengthening in the area of disclosure and transparency and more information in terms of the structures of commissions et cetera? Do you think that is what your member base is looking for?

Mr McKenzie—I am sure they would like anything that improves things. But, at root, we would like to see commissions from people giving advice disappear.

Mr PEARCE—Thank you very much.

Mr Forsyth—I would just add that we surveyed the 200 people that we had at the national conference which was held in July on the positions that we have put to you. In the ‘strongly agree’ column, the lowest recording was 62.2 per cent, which was for ‘require payment for services to be initiated by the client’, going up as high as 83.9 per cent for ‘remove the inherent conflicts of interest at present in the financial advisory industry’. I do believe that we actually sent a copy of this to the chairman.

Senator WILLIAMS—Mr McKenzie, you talked about your advice and what product to buy et cetera. You seemed to infer today that the Storm advice was very wrong. Was that what you were inferring—that you thought the Storm thing was a bad plan, bad advice? If I were selling cars and I talked you into buying a car that was not suited for your needs, even so, you would expect the car to have brakes, wouldn’t you?

Mr McKenzie—Yes.

Senator WILLIAMS—I just wanted to make that point. Someone is giving advice to people out there on a regular basis and the products that are for sale are there, and the people who actually putting those products together should also be aware that the ‘cars’ they sell should have brakes—just like in the finance world, the products are put together by the people who manufacture them and they should also have an obligation to ensure that their product is not just a time bomb. Would you agree?

Mr McKenzie—Yes.

Mr Forsyth—I recall reading in the paper a statement by Cassimatis that all of his advisers were operating on exactly the same principle. To the Australian Investors Association, that is a fundamental breach of what they are supposed to do. They are supposed to take everybody’s personal considerations into the advice that they given. But the advice that they were giving was: ‘Take out a loan on your home and then add another margin loan to that’—double gearing.

Senator MASON—When I questioned Mr Cassimatis on that, Senator McLucas gave him a medical analogy—a very good one—of someone who comes in with a cough and a cold. He said that everyone who came in was exactly the same. I said to him, ‘So a mid-30s executive or an independent retiree with millions of dollars of assets or a 70-year-old pensioner?’ His response was, ‘They are the same.’ Do you have a comment on that at all?

Mr McKenzie—Part of the Financial Services Reform Act says ‘know your client; know the consumer’. What he says just flies in the face of that.

Senator MASON—So one size does not fit all?

Mr McKenzie—If one size fitted all, there would be no need to have the ‘know your client’ rule that we work under.

Senator WILLIAMS—Isn’t it vital, as we move forward, for Australian public to regain confidence in the financial planning industry, that people in the industry must adhere to that very regulation and treat every person they give advice to on their individual circumstances? This surely must be essential for future confidence in the industry?

Mr McKenzie—Yes, I agree.

Mr ROBERT—If an investor is not happy with what is happening with their investments or are not happy with their adviser, what can they do at present?

Mr McKenzie—The can make a submission to the Financial Ombudsman Service—if it is under, I think, \$100,000 at the moment, heading up towards \$280,000, I believe, in the future..

Mr ROBERT—What if you are a sophisticated investor—you are over half a million?

Mr McKenzie—Sue.

Mr ROBERT—That's it?

Mr McKenzie—That is all I can think of.

Mr ROBERT—Do you believe that is appropriate?

Mr McKenzie—No.

Mr ROBERT—So what would you recommend to the committee—being a bunch of legislators? What would be more appropriate for people, across the spectrum—from unsophisticated to sophisticated investors—to do if they believed they were being screwed?

Mr McKenzie—There are only two possibilities. One is to go to court and one is to go to the Financial Ombudsman Service, and it is a matter of—

Mr ROBERT—Think outside the square a little. In your professional opinion—you guys are the big end in representing investors—do we need something different? Do we need something new?

Mr Forsyth—Thinking outside the square, I was talking to my son a couple of nights ago and he made the suggestion—to some extent with tongue in cheek—that, if these people who provided that advice got a 10 per cent commission on the money that was invested, perhaps they should also be forced to pay 10 per cent of the losses associated with that investment.

Mr McKenzie—There is only one additional thing. I was thinking about this yesterday, actually, and I was wondering what happened to the small claims tribunals that used to exist. I have not read about this and I do not know if they still exist—

Mr ROBERT—It still exists. If you have something under \$7,500, you can go to small claims at the magistrates. I am not too sure that will help people who are investing.

Mr McKenzie—No, we need something bigger than that. I think the Financial Ombudsman Service needs to go up to half a million or something like that.

CHAIRMAN—To summarise, you are saying that while the FSR may have served us well, and certainly some reform was needed at the time and everyone welcomed that, perhaps it is time for some further improvements and efficiencies, now that we have learnt over a period of time that there may be deficiencies. It is not a perfect system—I am making that assumption. Maybe we need to look at the rules that govern how people behave and how they act towards others and perhaps make it clearer to them what their responsibilities are.

Mr McKenzie—Yes, I believe so. To me, that act concentrated more on the form, the way things looked, rather than the substance. Many of us felt at the time that this was all about the way we write things down, the way we defend the advice that we are giving under the 'know your client and know your product' rule. The end result was reams of paper and no sufficient responsibility for the advice per se. So it was a matter of disclosure, a lot of documenting research and where it comes from, documenting the features of the person's situation. But, ultimately, whether or not that advice was the best advice for the person did not seem to be the

point, and I think that is what we want to have—a situation where the advice that is given to anybody who seeks advice is the advice that is most appropriate for them.

Mr Forsyth—Can I add one thing. When Senator McLucas was asking questions she mentioned that the Financial Planning Association were trying to move their members to get away from commissions. That particular move was strongly applauded by the Australian Investors Association.

CHAIRMAN—Your association members would obviously have been impacted by the downturn in the global financial markets. Can you generalise, or can you be specific about that?

Mr Forsyth—I can be specific about my own.

CHAIRMAN—Where have they ended up today? Are they in similar positions?

Mr Forsyth—I am happy to tell you that the capital value of my investments in shares and in property trusts, or REITs, halved from when the market reached its peak to when it reached its nadir, and I am glad to say that over the recent rally it has come back by \$100,000. But that is all it has come back. I am still well below where I was. My passive investment income has gone down by 36 per cent.

CHAIRMAN—Was your investment covered by debt?

Mr Forsyth—No. Goodness gracious me, no! My wife was a real estate agent at one stage and I talked her out of ever advising anybody into negative gearing on an investment property.

CHAIRMAN—There are lots of products in the market. It is almost impossible to list them all, there are just so many. Do you think it is the products that fail, or is it strategies that fail?

Mr McKenzie—That is an interesting one.

Mr Forsyth—I think it is the strategies more than the products.

Mr McKenzie—It is interesting. If any of our members who were at our conference in July 2007 took notice of one of our prime speakers they would have been out of the market in September. And, of course, the market fell in November. That particular fellow had cashed up completely, well before November 2007. So his strategy was what saved him. He would be waiting in cash to see what happens.

Mr Forsyth—He is going back into the market at this point in time. That is what he told us at the 2009 conference.

CHAIRMAN—Gentlemen, thank you very much. We really appreciate your time, your submission and your evidence today.

[12.21 pm]

KING, Ms Sharron, Private capacity

Evidence was taken via teleconference—

CHAIRMAN—Ms King, welcome. You were an investor with Storm?

Ms King—Yes, with Storm Financial.

CHAIRMAN—Would you like to make an opening statement?

Ms King—Good afternoon, Mr Ripoll and committee members. I wish to apologise for not being able to appear in person. I am aware that you have read my submission so I will not reiterate the facts that I presented unless the committee wishes me to do so. I hope that this inquiry will recognise the actions of the Commonwealth Bank, the Colonial Geared Investments and Storm for what they are—criminal frauds. Their actions and deceit have relieved me of 19 years of my savings and investment for my future. During the entire period of investment I have never once made a withdrawal and all dividends were reinvested.

I am astounded at the lies and deceit which is surfacing from CGI or Storm. In early November at a meeting of Storm clients in Mackay, Emmanuel Cassimatis stood in front of a room of 150 people and informed us how the world got to the financial state it was in and encouraged us to remain calm and stay with them through this financial crisis. ‘Mistakes have been made by the bank and these will be rectified,’ he said. There were people in the crowd who had already been sold down without knowledge. Within weeks, CGI had sold down the entire Storm badge funds and closed it without any notification other than the allegedly six minutes to Storm—none to clients. I never received a margin call and had already produced the two or three layers of protection from margin call when you reach buffer, as advised in our financial plan. I provided extra cash and extra security which covered the whole margin loan. This appears fruitless now as the whole portfolio was sold without consultation or notification.

This leads me to believe that there was some type of battle going on behind closed doors with CGI or that this was a well planned, orchestrated liquidation of Storm by CGI to provide themselves with available funds in a situation where the banks had their funds rapidly eroded—hard-working Australians being the collateral damage.

I believe that, before me, the Cassimatis’ have appeared at this inquiry. As a result of that are we getting to the truth of what is happening?

CHAIRMAN—Sorry, are you asking me a question?

Ms King—Yes.

CHAIRMAN—It is supposed to work the other way!

Ms King—What I am saying is that, with the parliamentary inquiry, I see that there are a few key players that are not going to appear as witnesses, one being John Clothier, and he is the head

of the margin lending. If we are not going to get to the bottom of it, perhaps a royal commission is what we need.

CHAIRMAN—Thanks for that, Ms King. There is an endless list of people who could or could not be called. There are a whole range of circumstances around all of that. We do have you here, though, and we are dealing with a whole range of other people. We are interested in hearing your evidence and we only have a limited time, so I am really interested, one, in your submission and, two, in what you have already told us and what you have yet to tell us. And we want to ask some questions, if we could, to try to understand better what took place. Your evidence is important to us.

Ms King—Okay. That is all I wanted to say.

CHAIRMAN—Can I start by saying thank you very much for your submission. There are some extraordinary things in the submission and some things that are similar to what other investors experienced and outlined in their submissions. An interesting point that seems to come out, and you just mentioned it, is that you never got out of the system—you got in, but you never got out—and you reinvested all of your funds or earnings. Obviously it happened to you, but does that appear to be the case right across all Storm investors? In a general sense, did they all stay and reinvest? They never realised their gains?

Ms King—I cannot speak for other Storm investors, but I also got my family into it and some work colleagues, which I obviously totally regret now. For me it has always been about the long-term investment—long-term goals. Through history it has been shown that when the market falls it eventually recovers above where it fell from as long as you are prepared to wait it out. To me it was like a savings account you put away and forgot about.

CHAIRMAN—Did you understand you had a debt and you had to service that debt?

Ms King—Yes. At the beginning, I serviced that debt myself by putting money into my DAM account and contributing. It got to the stage with the portfolio where it was able to carry itself—or I was told it was able to carry itself. With dividends and reinvesting they would make certain redemptions to pay for interest. Every tax return I put into the DAM account. When I had windfalls or a bit of money in the bank—I had separate savings—I would put it into the DAM account because that DAM account was there for the good times but also the bad so that, when the market did fall, I had that extra security there to rely upon to either offer the cash up or buy more shares to bring my LVR down. But that was never afforded to me.

CHAIRMAN—You say in your submission that you were encouraged to borrow more. Is that accurate? Were you encouraged to continue to borrow as the market rose?

Ms King—I have been with my adviser since I was 19. I started buying shares in 1996 and in 2000 I got a margin loan. I think the first time I increased my margin loan was in 2004. Approximately four years went by without the loan increasing. It has only been in the last three to four years, I would say, that I have found I have taken these next steps. My understanding was that my LVR was at a certain position and, as the market grew, I then attained more equity in my portfolio, so my LVR would go down and they would then say, ‘You’re able to borrow this much more to bring your LVR back up to where we had it.’ That was my understanding. As my

portfolio was growing I was getting equity in it and then borrowing more to make more dividends. It was then looking after itself.

CHAIRMAN—Were you being specifically advised to borrow and, as you say in your submission, to buy deeper into the market? Was that being done individually with you? Did you sit down and discuss a strategy or was it more, as you said, that it was just being generated through a computer system?

Ms King—It was generated. I live out in the country in North Queensland; my adviser is in Brisbane. At the times I went to Brisbane I would have a meeting with him. It was not regular—every three months, six months or something—but if I got next steps in the mail I would ring him and, especially if it was a next step within six months of the last one, ask what was going on. He was not aware of the next steps. He presented that it was an automated system that they had when you got a certain amount of equity in there. You were then put up to buy in more.

CHAIRMAN—So you were being advised by a computer system to keep buying?

Ms King—Yes. I have bashed myself up enough over this whole thing, but when you have been with someone since you were 19 you trust them explicitly and believe they have your interests.

CHAIRMAN—When did you first realise that you may have been having some problems with your portfolio?

Ms King—My last knowledge of my LVR was around 67 per cent, so when the market started to fall I knew that I would come close to or get a margin call. We were on the phone to our adviser from early October. I produced extra equity. I had my husband's business to cover the margin. There were all these precautions in place to show that we could service that debt and not sell anything out, because I did not want to realise my losses. Then on 14 November I got a letter in the PO box, saying that around 450,000 of my shares were sold. Prior to that, whenever shares were sold a letter was presented to me that I had to sign for the redemption. I never got anything of that. I contacted Storm, and my adviser was dumbfounded. He said I was not margin called. I demanded to be put back in the market. The next thing I found out was when everything was sold out, which was by 22 December and was only because I was on holidays with my mother and she received a phone call from Macquarie in relation to her matter. I could not talk to Storm advisers then and everything was sold.

CHAIRMAN—You have in your submission that in July of 2008 you received a letter from Storm requesting to lock your margin loan in with fixed interest of 9.25 per cent for a year and that you were directed to borrow more money to cover the interest on those borrowings themselves. You did question your adviser about your ability to pay the interest and about whether they were pushing the LVR way too high—to 85½ per cent. Is it still your view that they pushed it up too high?

Ms King—Yes. I read my financial plan from front to back when I initially went into this back in 2000. I have since read it front to back many times. In there it states that I am to stay between 40 and 60 and the maximum LVR that the bank will allow me to go to is 62. I always thought those things were in place. I knew I was at 67 and I asked my adviser: 'Obviously the

loan is getting quite large. Am I making enough dividends to cover this loan?' He said yes, and my thought at the time was, 'The portfolio can support it because the banks have these protocols in place that would not let me go over that.' I only found out I was at 84 after I got all the paperwork.

CHAIRMAN—Do you know who was directing this strategy of borrowing more and locking into an interest rate?

Ms King—I cannot tell you who within the Storm organisation did, but my adviser was the one that I spoke with, which is Stephen Halsall. With that loan with 60,000-odd thousand dollars in interest I signed a one-page statement and faxed it to Carmela. I realise now, but back then you think, 'Well, this obviously can be done because the organisation is doing it. But it was inferred to me that this was a special deal, something that was done for—'

CHAIRMAN—Sorry, but how was it inferred to you that there was a special deal?

Ms King—It was in the letter that was associated with it. I think Mr Cassimatis had mentioned in there you have a deadline and it is a special price. I would have to pull out the letter.

CHAIRMAN—That is okay. I just needed to comprehend it. So you were told that. There was a letter that said that somehow there was some sort of a special deal and you were special because of that or something.

Ms King—My understanding would be locking in the interest then also goes towards securing your loan for 12 months.

CHAIRMAN—Thanks for that.

Senator MASON—Ms King, I am Senator Brett Mason, the deputy chair of the committee. I will ask you a couple of questions on matters that have been touched on by the chairman. When your relationship commenced with Storm Financial, you negotiated a relevant LVR. Is that right?

Ms King—My initial involvement was with Nancy Seymour. She was independent at Holland Park. I think when I initially went with her she was with MLC and then the name changed. She went to Ozdaq and hence Storm. My financial plan was with Nancy. She was an authorised representative of Ozdaq. That was negotiated at between 40 and 60 per cent. It was stated throughout my plan that it was manageable.

Senator MASON—That was at between 40 and 60 because that was the way you were managing your risk. Is that right?

Ms King—Yes.

Senator MASON—I understand.

Ms King—That is the way I thought my advisers were managing my risk. It was a 'save, put away, don't think about it' sort of portfolio for me.

Senator MASON—I understand. So every time your LVR was changed you were informed. Is that right?

Ms King—No.

Senator MASON—So you weren't.

Ms King—On your statement it would have the LVR and that would change all the time. I just assumed that had something to do with a bank. It was still my personal one for me, which was 40 to 60 and not go above 60.

Senator MASON—So you did not sign anything or you did not agree to any change in your LVR outside the 40 to 60 per cent. Is that right?

Ms King—I did not.

Senator MASON—That is correct, isn't it?

Ms King—Yes, that is correct. I was just going to say I looked through extensive documents I have here last night. They change your spending limit, the available approved spending limit. That changed to 750 miraculously and I have never signed anything for that to be approved either.

Senator MASON—You mentioned in your oral evidence before and also in your written submission that you never received a margin call and that your shares were redeemed without your permission. Is that correct?

Ms King—Yes.

Senator MASON—Coming to the crux of it, on page 4 of your written submission, Ms King, down the bottom, in your second-last paragraph, you say:

I sent a complaint to John Clothier, Head of investment lending, Colonial on 9th February 2009 outlining my concerns and querying the lack of any contact regarding my margin loans and the subsequent selling down of the security. I received a reply in which he states; *"It was only December 2008, when CGI became aware that Storm had not been notifying its clients of the position of their margin loans accounts and there had been a prolonged period of inadequate responses to margin calls by Storm, that CGI took the extraordinary step of contacting borrowers directly" ...*

That is a direct quote from Mr Clothier, is it?

Ms King—Yes, that is from the letter that he sent me.

Senator MASON—All the evidence we have heard is that the relationship is between the bank and the client—that is, between, say, CGI and you. So why is he talking about an 'extraordinary step of contacting borrowers directly'?

Ms King—You are asking me what? I am a bit confused.

Senator MASON—The point is that many other banks lent margin loans to Storm clients and they contacted the clients directly. CGI did not until very—

Ms King—I went to 107 per cent and I still did not get contacted and they withdrew money out of my Macquarie account without my authorisation. So tell me how that works? They have not got active enduring power of attorney over my account.

Senator MASON—We do not know, Ms King.

Senator WILLIAMS—Just following on from Senator Mason's point on your letter from Mr Clothier, you say on the front page of your submission:

Information in the financial plan and from Colonial original loan approval documents was that in the event of my portfolio reaching buffer and margin trigger points I would be contacted by the lender and given notice to correct the LVR. This is documented and available.

Ms King—In my financial plan it is documented the lender will also monitor your portfolio daily, the lender will require you to make a margin call and the lender will ask you to provide additional funds to restore at least the minimum equity position. I have the original document from Colonial for my loan. In the back it talks about how it will notify you. Obviously this will be up to a court of law, but it depends on how they define 'you'. My advisers did not take the application out. It is in my name. They are not acting as an agent. It does not say 'as an agent' in there. So my understanding is that I am their client and they are to advise me. That is what it is in my financial plan and the associated letter that came from Colonial at the time of taking the loan out.

Senator WILLIAMS—I am just wondering what your reaction was when you received that email from Mr Clothier, who stated, 'We have taken the extraordinary step of contacting you personally.' Was that a surprise?

Ms King—I was furious. Why do you think I have written letters and made submissions? I have been a detective for nearly 20 years. I have spent my life trying to protect people and bring to justice people who do wrongs against the law. I just cannot see why people in executive high positions of great corporations should get away with blatant lies to and deception of ordinary people. ASIC has started moving along, we have got SICAG involved and everyone is united. But we were stomped on at the beginning and told to forget about it. That is where it would have stayed if this had not occurred.

Senator MASON—It becomes more curious, looking at Mr Clothier's letter to you, because in SICAG's submission they cite Mr Paul Johnston, who was the head of Colonial margin lending from its inception.

Ms King—That is the gentleman whose signature is on the bottom of my initial margin loan.

Senator MASON—He was the head of Colonial margin lending from early 1996 until his departure in 2003. His evidence is that, first of all:

The margin call was always automatically generated by a computer system used by the bank ... A margin call notice could only be stopped through manual intervention—

This is an issue that Mr Robert raised earlier with Mr Cassimatis. Secondly, Mr Johnson says:

I was instrumental in the writing of clause 4.2 of the terms and conditions which talks about 'you' receiving a margin call. My knowledge and practical application of that clause is that the bank contact the client in writing ...

Ms King—Yes.

Senator MASON—Yet that did not happen, did it?

Ms King—That did not happen to me. You were saying it is an automated system. Obviously, when they withdrew the \$40,000 without my approval, put it into their ACA account and then tried to take it out to put onto a loan that they had created, they automated a dishonour notice, which I received in the mail. I actually rang up the Commonwealth Bank because I thought someone had stolen my identity and opened up a Commonwealth Bank account in my name.

Senator MASON—Sure. The interesting part, which is what Mr Robert was adverting to earlier with Mr Cassimatis, is that 'a margin call notice can only be stopped through manual intervention or some agreement, partnership or some other arrangement between particular parties'.

Ms King—I have never been notified, from my initial financial plan, of any change of any arrangement in relation to any of that.

Senator MASON—I am sure you have not. But you do say, in the third paragraph of page 2 of your submission:

In hindsight, it appears that there is a level of collusion between the data systems at Storm and CGI where information sharing was taking place ...

Do you stand by that?

Ms King—Yes, and that relates to when I got my next steps, which my adviser did not know about.

Senator MASON—We are going to have to investigate, obviously, the relationship between CGI and Storm Financial.

Senator McLUCAS—Ms King, I have a couple of little technical questions. On page 2 of your submission you use the term 'broker' to describe Mr Halsall. Do you use the terms 'broker' and 'adviser' interchangeably?

Ms King—I did this up and just got someone to tweak it for me.

Senator McLUCAS—I was not reading anything into it, but there is quite—

Ms King—Under the technical definition of ‘broker’, my adviser was not that.

Senator McLUCAS—So he was your adviser?

Ms King—Yes, he was my adviser, not my broker.

Senator McLUCAS—You also say that Mr Halsall:

... claimed that he had not received any advice and that some form of arrangement had been made ...

Do you know anything more than that?

Ms King—No. To me, we were going to be carried through, I suppose, which is ultimately what Mr Cassimatis obviously wanted to happen.

Senator McLUCAS—But he gave you no more information than that some sort of arrangement had been made?

Ms King—No.

Senator McLUCAS—Okay. Thank you for that. I have a technical question. Like many other people, you continued to reinvest in what were going to be your retirement savings. I quote your submission:

No money has ever been realized from the portfolio ...

Ms King—No, never.

Senator McLUCAS—Did you ever try to withdraw any money?

Ms King—No.

Senator McLUCAS—My final question is a broader question. You may have some advice for the committee or you may not. This is really important. You are a long-term investor—

Ms King—Yes.

Senator McLUCAS—and you have been hurt very badly, as have many others. Do you have any advice to our committee about what we should be recommending to government as to what would have assisted you in your relationship with your adviser or your relationship with the bank so that this event could have been prevented? Is there anything that we as a government can do to help ensure that this does not happen again?

Ms King—What you can do to ensure this does not happen again is to bring the principal offenders, the culprits to justice and put in jail as a warning example to others. If those who created this are not brought to justice then history will just repeat itself.

Senator McLUCAS—Ms King, we are not a court of law.

Ms King—I know you are not.

Senator McLUCAS—We are legislators. What we can do—

Ms King—Maybe that is where a royal commission is needed.

Senator McLUCAS—I understand your recommendation around that. Our task is to look at the regulatory arrangements that are currently in place, assess them, and see if there are any changes that are required or could be made that would assist that power relationship between the investor, the bank and the adviser. In my view, I think people possibly need more information to be able to—

Ms King—I had all my information and I thought I understood it quite clearly.

Senator McLUCAS—Yes, that is evident to me.

Ms King—What has broken down is that the steps that they said would be taken did not happen, other than also advisers being commission based. It is evident now that they were looking at how to line their pockets instead of lining the pockets of the investor.

Senator McLUCAS—So there are two issues there: things that you expected to happen did not happen, and the question that we have got then is how do we make sure that what you expect occurs; and, secondly, the whole question of trailing commissions et cetera.

Ms King—What is deterrence? Deterrence is consequences, so I think the biggest cost—if advisers or banks do not do the right thing—is that there are harsh penalties and consequences that are associated with it.

Senator McLUCAS—Essentially, you are saying that there needs to be a fiduciary duty.

Ms King—Yes.

Senator McLUCAS—Thank you very much for your submission.

Mr PEARCE—Ms King, I want to ask you just a couple of questions picking up from your submission on page 3 in particular. You say in paragraph 2 that ‘over the subsequent years I was encouraged to loan more by Storm Financial Services’. Can you share with the committee how you were encouraged?

Ms King—You would get next-step booklets. In them there was a mountain of information saying that the market has risen; that you have obtained equity; you are able to take the next step of investing \$50,000; this is the time. It was always presented. Then when I questioned my adviser it was always presented as: ‘This is a smart thing to do. You are nuts if you don’t do it.’ That is the way it worked with them.

Mr PEARCE—Did you go to education seminars?

Ms King—Yes, back in 2000.

Mr PEARCE—Right. That was at the invitation of whom?

Ms King—Of my adviser. I was with my adviser when, I think, she was with MLC and then she changed over. Then we were required to attend these seminars. They were in Brisbane.

Mr PEARCE—You say in your submission that ‘all my dividends from the portfolio were automatically reinvested’. How did that actually start to take effect? Can you recall that?

Ms King—When I first started I was in the police academy, when I met Mrs Seymour; obviously stone broke, had nothing—I had savings that I initially bought shares with. When that grew I also got a windfall. I had \$40,000. From that we started a small margin loan in 2000. That is how it started. Back then I owned a house, though, and I just think that Mrs Seymour had an independent—just a slightly different—view from what Storm did, because she never suggested to me to mortgage my house.

Mr PEARCE—Just on this automatic thing, I am interested to know whether each time you got a dividend did you sign off that you wanted to put it back in or did it just happen without you seeing it?

Ms King—In not the loan contract—in the dividend pages that I have here, the application for it to go into whatever fund it was going in, down the bottom it has got that reinvesting dividends remains unchanged.

Mr PEARCE—All right. Also in your submission you say: ‘My personal circumstances were provided to my adviser continually.’

Ms King—Yes.

Mr PEARCE—How were you doing that? Can you share with us?

Ms King—To us, Nancy and Stephen were long-term friends. They sent me presents on the birth of my first child. We would catch up in Brisbane but we were treated like a member of their family. When you saw them regularly, obviously you would catch up on your lives, or they would ring to touch base to see how everything was going.

Mr PEARCE—Did you submit statements or was it more informal?

Ms King—Informal. I requested all the documents from KordaMentha, but I did not receive everything from over the 19 years. I know I filled out financial plans showing how much my income and outgoings were. I just cannot recall if I had an updated one. They knew when I had my first child. Hang on, yes, I did provide one for them because I showed them exactly how much I was getting and then with subsequent children they knew I was receiving nothing. I even showed them when I sold my house.

Mr PEARCE—Thank you very much.

CHAIRMAN—How did you feel about the relationship between you and your adviser? You said it was family-like.

Ms King—Yes.

CHAIRMAN—Did you ever seek to question the advice?

Ms King—Yes. He was also the adviser for my mother. You want to believe there is good in people and I just hope that he was being fed the same lies, because I do not know how they sleep at night. Stephen was involved with my family. My father got sick and died of cancer within three months. He went through that with us and then assisted my mother after the death. He went through some hard times with us. I just hope that what he told us was true. I have questioned him since and said: ‘You are a financial adviser. Don’t you see that this was the wrong thing to do, especially in relation to my mother?’ She was geared ridiculously, unbeknown to me. He said, ‘He was just following what Cassimatis had put in place for pensioners, for retirees.’

CHAIRMAN—With that comment, do you think your adviser understood what he was doing?

Ms King—I would think so. He trained under Nancy from when he finished school. He worked in the position for that long. But I suppose it is like any organisation: you work for an employer and you are going to do what they say. If he felt that strongly and did not approve of the way they were lending to people, he would have resigned, but he never did. We just kept going along. That is why I stayed with Stephen. I live up in North Queensland. I could have easily gone to a financial adviser in Mackay or Townsville, but I chose to fly down to Brisbane because I felt that we had a relationship of protection, that the bottom line was that he would always look after our interests ahead of the organisation’s. But it turned out that that was not the case.

CHAIRMAN—Ms King, is there anything further you would like the committee to know?

Ms King—No, I think I have given it all to you, other than that I want people brought to justice.

CHAIRMAN—We hear what you are telling us. Thank you very much. It takes a fair amount of courage to come forward and speak. We really appreciate your time and the evidence you have given us, and we appreciate your submission. Thanks very much.

Proceedings suspended from 12.58 pm to 1.37 pm

ANDERSON, Mr Graham John, Secretary/Treasurer, Storm Investors Consumer Action Group

O'BRIEN, Mr Noel Terence, Co-Chairman, Storm Investors Consumer Action Group

WEIR, Mr Mark Robert, Co-Chairman, Storm Investors Consumer Action Group

CHAIRMAN—Welcome back everybody, and I welcome representatives of the Storm Investors Consumer Action Group. Would any of you like to make an opening statement?

Mr Weir—We appear before you, the representatives of the parliament of this great country in which we are privileged to live, safe in the knowledge that you are the custodians of a standard of social justice that is the envy of many and one which we all enjoy and probably take too much for granted. Needless to say it is in this context that you have convened this inquiry in the knowledge that there has occurred a breakdown in the fundamental elements of social justice that underpins the very structure of all civilised societies. The concept of social justice or as we colloquially know or term it in Australia as, 'the principle of a fair go,' is fundamental to the rule of law that has defined civilised society since human beings first began organising themselves into shared societies. It is the cornerstone of the framework that separates humankind from the animal kingdom and, as such, it should be nurtured lovingly and defended stoutly when threatened.

We stand before you today as humble representatives of a group of Australians whose lives and financial wellbeing have been gutted principally because the normal protocols of social justice and fair play were not observed. The chaos leading up to the collapse of Storm and the abject failure by the bank to exercise even a basic level of due diligence by informing its clients of the perilous position their financial affairs were in at the time, thereby snuffing out their income streams and the capacity to ride out the crisis, was indicative of a return to the law of the jungle.

Our members were the innocent victims of heartless predators who gave them no chance of survival. Ironically, the predators were the very people they trusted to chart their financial destiny through the tempest that befell them. That is why you, as representatives of the democratic nation that went to war to defend the principles of social justice and fairness for all, and we, representatives of a group of Australians who do not get a fair go by any definition of the term, find ourselves at this forum today.

The terms of reference of this joint parliamentary inquiry include a specific brief to, among other things, discover why this injustice has occurred, examine the events surrounding it and, hopefully, as an outcome, to put in place appropriate mechanisms to restore the balance and to ensure that such destructive events can never be repeated. In appearing here today as representatives of those who have suffered as a result of these cataclysmic events, we express our gratitude for the privilege of playing our part to assist in this process on behalf of all of those who have suffered.

As outlined in the submission to your committee, SICAG was borne out of a separate need to provide a support group and to attempt to get answers as to how members' investment portfolios came to be entirely destroyed. Prominent in SICAG's mission statement, formulated around a table in a member's suburban backyard some eight months ago, was a call for the establishment of a parliamentary inquiry into the events surrounding the destruction of Storm Financial, and accordingly SICAG quite rightly takes some credit for the establishment of this inquiry.

It is not sufficient to identify the global financial crisis as the sole reason for these events although realistically it may be seen as the catalyst that set off a chain of destruction. It is also not necessary to dwell on why SICAG was and remains a crucial contributor to the continued wellbeing of those traumatised by the events under consideration. Having said that, we cannot overstate to the honourable members of this committee the magnitude of the appalling human despair these events have caused.

As honourable members of this committee will be aware, there are three stakeholders in the events leading to the destruction of the assets of our members: firstly, the members of the banking industry; secondly, Storm Financial; and thirdly, the one on whom the first two depended for their very existence, their clients. Much has been said and written surrounding the Storm investment model, and investigations are running concurrently with this inquiry into all aspects of that strategy. Once these have run their course, the resulting reports will either condemn or support the legitimacy of that investment model. Irrespective of that outcome, however, we are compelled to reinforce the view that all of our members, being representative of the complete spectrum of financial investment sophistication, were doing nothing less honourable than following what they perceived to be a legitimate strategy to generate wealth directed towards providing an independent retirement for them and their loved ones, or were already achieving or funding that objective.

We are compelled to say that there would not be one among our members who would have willingly entered into this strategy had they known that all of the mechanisms designed to manage the volatility of investing in the capital market were going to be repudiated in such a destructive manner and without warning. It is in this context that the distortion of the fundamental fabric of social justice has occurred. It came about because those players in the game who held all of the might and power—and let there be no mistake to whom we are referring here and that is the banking industry—recklessly misused that might and power when the going got tough by ignoring the fundamental rights of their clients. In their omnipotence and arrogance it was as if their clients did not exist. They clearly did not take into account the human consequences of their precipitative action to shut down the Storm indexed funds without warning. We simply became the sacrificial lambs on the altar of their own greed and self preservation at the very time when we needed the support of the institutions that we had trusted so implicitly to exercise a duty of care to their customers. As a consequence they allowed us to be totally destroyed.

We now see a scenario wherein the bank with the most exposure, the Commonwealth Bank, a key player in all facets of the Storm investment model, is behaving like a reincarnated Pontius Pilate in denying the symbiotic nature of its partnership with Storm. Evidence before this committee shows patently that the Commonwealth Bank had what can only be described as an umbilical connection with Storm Financial, one that has endured for many years. A key factor in the decision by the majority of our members to engage in the Storm strategy was the strength of

the Storm connection with the Commonwealth Bank and its funds management division, Colonial First State.

When the full weight of evidence is considered by the honourable members of this committee, we believe it will be sufficiently compelling to cause you to conclude that a grave breach of the principles of social justice has undoubtedly occurred. Accordingly, we implore you to do whatever is within your power to censure those who deserve your strongest condemnation for their actions that have caused this disaster to reverberate widely through the community. The community will be carrying the burden and counting the cost of this unconscionable conduct for years to come. We fervently trust that the all-powerful banking industry might come to understand the power that they exert in society and that that must be matched by commensurate responsibility to behave with a conscience and a duty of care towards those to whom they owe their existence in this society. Ironically, these are the same ordinary Australians whose taxes were used to protect the banks against the icy winds generated by the current global financial crisis. Great damage has been done, not only to the financial and psychological wellbeing of our members but also to the reputation of the banking industry.

Our fathers and grandfathers trusted their bank manager implicitly and accepted their advice, safe in the knowledge that the banker would act in the customer's best interests at all times. Sadly, that cannot be said of today's salesmen-bankers, whose reckless lending practices and rapacious quest for profits at any cost continue to do irreparable harm to the banking industry's integrity, credibility and once envied reputation.

We appear before you today safe in the knowledge that the good men and women appointed to serve on this committee share our concern for the preservation of the principles of social justice that I referred to earlier. We are hopeful that your findings will result in the events that have brought us together today never happening again. We are also hopeful that the bank may eventually admit to the full extent of their culpability in these events and then act with honour and do whatever is necessary to redress the pain and suffering their actions have caused.

Before I and my colleagues take our leave and allow you to continue your important work, I would like to leave you with a quotation from the United States President, Barack Obama, that succinctly sums up our members' sentiments in relation to this inquiry:

If the people cannot trust their government to do the job for which it exists—to protect them and to promote their common welfare—all else is lost.

We thank you for this opportunity to tell our story and we wish you well in your deliberations.

CHAIRMAN—Thank you. I understand that you are representing pretty much all the investors that were involved with Storm. I assume that, in the many discussions and meetings you would have had, you have developed a fair sense of the issues and some of the things that happened within Storm. As we have heard from witnesses and submitters, a lot of trust was placed in the advisers—the people you dealt with directly. How would you describe that level of trust? How would you describe the amount of power that was bestowed upon those advisers to act on your behalf?

Mr O'Brien—Allow me to begin because I am not sure if the committee is aware that our son is our adviser and obviously there was trust between us and still is and always will be. There is no conflict of interest here, but it may be more appropriate for the other two gentlemen to comment further on that. We—I and my family and friends—had the greatest trust in our son as our adviser and we still do.

Mr Anderson—I have no problem with my financial adviser, but I do have problems with some of the things that were not declared by Storm Financial. My understanding of financial advice is that it is independent and it is suited to my needs. Since I have been involved with the committee of SICAG, I have found out that this is not the case and that two clauses appear on every statement of advice. They basically say:

We have identified that your current asset base is not large enough to fund the lifestyle that you desire now, or in the future. You have sought our advice on ways to expand your income streams so that you can become more financially independent from work and have lifestyle choices in the future. To improve the provision of capital growth and income for the future, the size of your asset base should be increased.

Attempting to purchase assets solely by using your surplus income would result in a relatively small change in the size of your assets base; hence there would be an excessive delay before your investment delivered a substantial change to your income or delivered significant growth.

We recommend that you mobilise your existing assets to produce an increase in the size of your asset base. This could be achieved effectively by purchasing liability and offering your existing assets as security for the loans. The liability would in turn be used to purchase high quality assets to provide capital growth. This capital growth will be converted to income streams over time. In doing so, you would be effectively purchasing the capital base that you require for real wealth creation.

Care must be taken that these liabilities are kept at levels that are safe and that the servicing of the liabilities is easily manageable, and both of these aspects have been of paramount importance in the construction of these recommendations.

To me, if that is on everybody's statement of advice, I have a problem with that.

CHAIRMAN—What does it mean to you?

Mr Anderson—It basically means that you are going to have to borrow money to fund your retirement.

CHAIRMAN—Was that never explained to you?

Mr Anderson—It was explained to me, and in the way it was presented it made a lot of sense. But the fact that everybody got that same advice shows the cookie cutter mentality. That annoys me, and the fact that the financial adviser is basically being controlled by the directors of Storm. I find that a bit of a conflict as well.

CHAIRMAN—If I understand this right, you are generally saying you trusted the advisers—

Mr Anderson—I did, yes.

CHAIRMAN—but you did not necessarily trust Storm.

Mr Anderson—No.

CHAIRMAN—How do you separate the two? I am not sure how we would do that. How do you separate them? You trusted the advisers but not the people who employed them.

Mr O'Brien—I think things have changed. Our original relationship was with Jelich Jones in Redcliffe, in our personal situation, and I think this will apply to a lot of our members. We have to keep getting back to the members, because it is not about us. To answer that question, once Storm started to acquire these other businesses and took the power back to a head office scenario for control and for whatever economies of scale, the advice lost some of its personality, if you like. The advisers were still there for us—they were still available 24/7—but there were some restrictions on the parameters of advice that they could give. We have heard previously that one out of four went down that cookie cutter trail, if you like.

CHAIRMAN—Sorry, one out of four investors or advisers?

Mr O'Brien—One out of four investors came along with the Storm philosophy.

CHAIRMAN—Were you ever concerned as this change was taking place, or did the advisers or anyone else acting as their representatives ever say that they were concerned about this change of culture?

Mr Weir—I guess as clients we did not think about it too much. From a personal point of view, I had had experience from the mid-nineties in using gearing to—I think this is the word that has been used; I don't like it myself—supercharge investment strategies by using margin loans.

When it came time to retire, in 2004, I went through an exhaustive process of ascertaining how I might best fund my retirement. I suggested at one moment I might keep my interest in the taxi industry, lease them out and live on the proceeds. I looked at self-managed superannuation funds. I looked at freehold motels. I looked at allocated pensions. Because of the criteria that I applied to that decision-making process, none of them really met those requirements. I undertook close consultation with my financial adviser at the time, Mr Jelich. He was establishing a stronger connection with Storm Financial at the time and suggested that maybe it was time I talked to Storm. The rest is history, I guess.

We did not think too much about the rationalisation of the organisation. It seemed to be an extremely efficient process. Much has been said about the protracted time that is required to finally put your foot on the sticky paper, so to speak—to become an investor. We were impressed with the trouble that they went to in regard to what is referred to as the education process, which did place a lot of emphasis on the historical nature of the equities market: the fact that the equities market was an economic principle that underpinned the economies of most of the developed countries of the world, that we were investing in a representation of the most solid companies in the ASX 300. We were given the opportunity to understand the principles of volatility as opposed to real risk and at the end of the day we thought that the mechanisms or the stop-loss processes that were part of that process were going to work in our favour. There are

times when I believe that they did tamper with the principles of the strategy, whereby we were supposed to keep a dam to enable us to withstand any down spikes in the market. My attitude was, 'Why have that cash sitting there?' At that point I should have been told that it is there for a purpose. My attitude was, 'Get it into the market and get it working for us.' That was one of the fundamental principles that was ignored. Also, as was addressed this morning, the 90 per cent LVR was a serious mistake in market circumstances that we had just been through.

CHAIRMAN—You talked about the power of the banking industry and that people once upon a time accepted advice from their bank manager and from their bank. With your investments, collectively as a group or individually, to the best of your knowledge how many times did you meet with bank representatives to accept their advice.

Mr Weir—One of the strategies that I chose was based on a self-managed superannuation fund provided by my bank. You will be interested to know that it had an element of subprime in regard to one of the aspects of that in that they were encouraging me to invest directly in projects whereby I might receive an enhancement in the rate of interest rather than invest in the bank's products. In other words I was wearing the risk for that additional exposure and getting in return a couple of per cent in my return.

CHAIRMAN—Was that a Storm product?

Mr Weir—No, it was not a Storm product; it worked on the basis that another of the bank's clients approached them for finance and they drew up a trust—

CHAIRMAN—Who are you talking about?

Mr Weir—Westpac. They would encourage their clients to invest directly in that portfolio—in that trust—

CHAIRMAN—So you were getting advice personally?

Mr Weir—Yes, from Westpac.

CHAIRMAN—And from Storm?

Mr Weir—No, this is nothing to do with Storm at all. This was a self-managed superannuation fund that was going to be set up and organised by Westpac.

CHAIRMAN—I am not sure if you understand: the one thing we are not doing in this inquiry is investigating into superannuation funds.

Mr Weir—Sorry, I thought your question was directed to—

CHAIRMAN—No. I just wanted to better understand it. Sorry, I am not sure if you understood that. You received advice from your adviser. Who was your adviser?

Mr Weir—This was prior to my joining Storm. This was an adviser I went to when I was determining what strategy I was going to use to fund my retirement.

CHAIRMAN—Are you representing SICAG, or—

Mr Weir—Yes.

CHAIRMAN—You are. In the good times obviously things are good, things go up and people make money. We all understand that and we understand the difficulties around those sorts of issues. Can you describe what was happening when the market started to fall so that we can understand what was happening at a client level and we can get a better idea of what people were thinking, what they were saying, were they worried, were they concerned and what were their concerns.

Mr O'Brien—I think that as the market started to fall at such a rapid rate we all had concerns about what was happening. The general feeling that we were getting was that part of the philosophy of our investment was to hang on to all the eggs we had in the basket or not to eat the chickens or whatever. One of the rules or beliefs was 'don't sell'. You do not have a loss until you sell. That really was part of it. We were continually being encouraged, through discussions among ourselves and financial updates, that our strategies were strong and that the company was very strong financially if things were to get very grim.

CHAIRMAN—Who was telling you that?

Mr O'Brien—Anybody that we spoke to, generally within discussions with clients, within discussions with our advisers. Obviously, there was never any discussion from the banks. Most of us in this room would not have received any advice in that regard from the banks, I would have thought, although whenever you had contact with banks, to re-establish a retail loan or whatever, it was common knowledge among all of the banks that the money was going back into the Storm fund with comments like: 'Good on you! Well done! The market's going well.' So they were aware of where our investments were going. But to get back to the point, as the market started to slide we were all confident that we had enough steps in place and checks and balances through Storm Financial to help us ride out what we believed was an inevitable glitch in the market, if you like. So to hold on was of paramount importance.

CHAIRMAN—Do you know what steps they actually took rather than the ones they might have told you about?

Mr O'Brien—The steps were already built in. We all believed that we had enough buffer in there to ride out up to the most catastrophic collapse in the market. I think we have heard comments and read them in submissions that the world would have to come to an end or we would have to have a complete financial meltdown before we got anywhere near a margin call, and of course that is exactly what we had. So we believed that those checks and balances were in there and they were nice and sound and solid. Obviously, by the time we got to the situation where there was the point of no return we still believed, naively or not, that, had we not been sold out and cashed up or whatever, if only we had been left alone and supported by the bank that had shown so much interest. We were very proud that Storm was involved with CBA, and I think most of the advisers were too, because of the strength of the relationship. But when they finally cut the legs out from under us we had nowhere to go, and I believe the market has probably recovered about 40 per cent so far from its lowest point. So now we are sitting here without a cracker, let alone in the bank, and watching this go back up. Of course that just adds to

all the stress levels. We believed totally—and when I say ‘we’ I am sure I am referring to the majority of SICAG people—that we were on a winner. By that I do not mean we were gambling and rolling the dice. We believed that we had invested in a very conservative product—that is, the economy of Australia, one of the strongest albeit one of the smallest economies in the world. There were no overseas investments. There were no flash, hot-shot ideas. We were looking for our 10, 11 or 12 per cent return annually in among the rises. Let us remember that when we first started in 1993 there were many years when there was no return through the All Ordinaries index at all. So when we started to get some good returns things were looking very rosy.

CHAIRMAN—Who was telling you that you could get 10 to 12 per cent annually?

Mr O’Brien—History. Over the last 100 years I think the All Ordinaries index has returned about 11 per cent.

Mr Weir—Being dividends reinvested. The historical statistical record of 100 years of investing in the equities market in Australia before the crunch was 12 per cent annually or thereabouts.

Senator MASON—Gentlemen, you say in your opening submission that a key factor in the decision by the majority of your members to engage in the Storm strategy was the strength of Storm’s connection to the Commonwealth Bank and its margin-lending division, Colonial. So it was a key factor in fact in choosing to engage with Storm. Is that right?

Mr O’Brien—It was very comforting to know that we had the support of the biggest bank, basically.

Mr Weir—Anybody with any knowledge of investing in managed funds would have been aware that Colonial First State had been a stand-out performer over any number of years. When I found that the investment in Storm was associated with First State then a lot of my apprehensions regarding the safety of my portfolio were dispelled.

Senator MASON—Could I just draw your attention to the section in your written submission under the heading, ‘Just who is responsible.’ Can we go there?

Mr O’Brien—Do we have the page?

Senator MASON—On page 23, at the bottom, it says, ‘Just who is responsible,’ and then we go over the page. So in a sense it is at the top of page 24 of your written submission.

Mr Weir—Is that the SICAG submission?

Senator MASON—Yes, SICAG. Do you have that, gentlemen?

Mr Weir—Yes. Thank you.

Senator MASON—When you established a relationship with Storm, was the LVR margin call trigger explicit?

Mr Weir—Absolutely.

Senator MASON—Righto; it was explicit. So you knew when the margin call would arrive.

Mr Weir—Absolutely.

Senator MASON—Was the process of the margin calls made explicit? In other words, what would happen? Who would action the margin call? Was that made explicit?

Mr O'Brien—I go back to 1993. Not long after starting our investments through Jelich Jones, in the MLC all ords fund at that particular time, we went to margin call. We received advice from the bank and then were contacted by the adviser that we had gone into a margin call. And then we were given instructions on how to fix it up. It was as simple as taking a handful of cash out of one bank and going to another bank and putting it into an account number that went into trust.

Senator MASON—I see. So the process was that you received a call from your bank and then a follow-up from the financial adviser.

Mr O'Brien—Correct.

Mr Weir—My product disclosure statement simply stated, 'You will get a margin call.' That document was owned by Colonial First State. It had a Storm badge on the front of it but it was owned and produced by Colonial First State, and I assumed that they would be contacting me for a margin call.

Senator MASON—Who would?

Mr Weir—Colonial First State. They owned the document.

Senator MASON—And they are bearing the risk, of course, because they are supplying—

Mr Weir—Colonial First State do not bear any risk. Colonial Geared Investment—

Senator MASON—Sorry, yes, CGI bears the risk because they lent you the money.

Mr Weir—That is right.

Senator MASON—All right; that is fine.

Mr O'Brien—Could I just make a quick comment about the margin call. We will not harp on it but there were not many of them.

Senator MASON—Prior to 2008, there weren't many?

Mr O'Brien—Sorry; there were not many of them prior to 2008. In our association, and having had a portfolio back to 1993, there was one. So it was not a topic that was discussed

frequently. I guess it was in the conditions—the ‘Ts and Cs’ someone was calling it yesterday—and it was not something that we all paid a great deal of attention to, I suppose. But all of us were always of the understanding that the banks had lent us the money and that it would be up to them if there was a margin call situation or, if they had any problem whatsoever with the lending process, that it would be up to them to contact their clients direct.

Senator MASON—You cite in your submission some evidence from Mr Paul Johnston, who was the head of Colonial margin lending from early 1996 until he left in 2003. You say that Mr Johnston is unwell but he is happy to give evidence if required. I take it the summation of his evidence is accurate.

Mr Weir—To the best of our knowledge, and knowing Mr Johnston’s integrity, we believe that that statement is authentic and true.

Senator MASON—On page 25 at lines 467 and 468 Mr Johnston makes the point:

The loan agreement is and always had been between the client and the borrower, not the agent—in this case Storm.

So the loan is between the client and the borrower. And that is what you said, Mr O’Brien, isn’t it?

Mr O’Brien—Yes.

Senator MASON—Then on page 26, lines 486-489 he says:

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

Is that right?

Mr O’Brien—That is according to Paul Johnston.

Senator MASON—That is right. Mr Robert drew out some of the evidence earlier today from Mr Cassimatis that normally these are generated by computers and can only be stopped by manual intervention. In the next dot point Mr Johnston states:

I was instrumental in the writing of clause 4.2 of the terms and conditions which talks about ‘you’ receiving a margin call. My knowledge and practical application of that clause is that the bank contact the client in writing ...

Again, is that your understanding?

Mr O’Brien—Yes; with a copy to the adviser. A carbon copy of that letter was sent to the adviser at the same time. That was our understanding.

Senator MASON—All right. Good. I am going to turn to a letter attached to Mr Jelich’s submission. On page 27, line 520, it states:

... the CBA might have a case to answer in regard to deceptive and misleading conduct by circulating a letter to clients asserting that Storm had sole responsibility for managing it and the bank's clients' margin loans.

Do you have a copy of that letter to clients?

Mr O'Brien—I can provide a copy. That was a copy that was circulated by Colonial following the sell down, and an interlocutory injunction was taken out by Storm Financial—

Senator MASON—I understand that, but you are asserting that the CBA, in that letter, asserts that Storm had sole responsibility for managing it and the bank's clients' margin loans. Is that right?

Mr O'Brien—That is their allegation.

Senator MASON—That is quite different from the evidence that Mr Johnston is putting forward about the normal process for margin loans; isn't it?

Mr O'Brien—Absolutely. Obviously things changed after Mr Johnston left; we assume.

Senator MASON—Let's get to that right now. In your submission you talk about a letter from Colonial Geared Investments to Mr Cassimatis dated 18 May 2007. Are you aware of that document?

Mr O'Brien—Yes; May 2007 agreement.

Senator MASON—Yes; that is the one. There are a couple of issues that I want to take you to here. It says:

Dear Emmanuel

Re: Margin Lending for clients of Storm Financial

Following your discussions with Colonial Geared Investments we are pleased to provide the following terms for margin lending facilities for your clients.

Subject to the expectations set out below, we will allocate a global LVR of 80% for those of your clients who invest in the following funds ...

About 10 funds are then listed below. Were people notified of the change in LVR?

Mr Anderson—No.

Senator MASON—They were not?

Mr Anderson—No.

Mr Weir—We never received correspondence to that effect. It was delivered to us in a round of investor updates. The date escapes me but it would have been in 2007 at a meeting at Margate on the Redcliffe peninsula, where we were told, with a great deal of fanfare, that Mr Cassimatis had negotiated an 80 per cent buffer, a 90 per cent margin call. I have to say that, on the face of it, that was received pretty well by most people.

Senator MASON—Just remind me when that was, again.

Mr Weir—It would have been in 2007. It would be fair to say that that would have been received pretty well by most investors, knowing that you are not going to get a margin call to 90 per cent. Little did we realise that it was the old Achilles heel when things went bad.

Senator MASON—By changing the LVR, of course, you are changing your risk; aren't you?

Mr Weir—When things go pear shaped, you have very little margin for error after 90 per cent.

Senator MASON—So the evidence you are giving to the committee, gentlemen, is that clients who invested in those funds were not informed by Storm or by Colonial Geared Investments.

Mr O'Brien—Only through verbal updates, as Mark just said. And it was accepted—

Senator MASON—Only through verbal updates?

Mr O'Brien—Yes. There was never any writing and there was no change of contract. It was used as a further sign of the support, if you like, that Storm clients had from CBA Colonial. It was used as a positive pointer to say, 'Hey, we have so much faith in your portfolios that we are willing to extend to you, Mr Investor, through Storm an extended LVR'. Little were we to know that we would ever get to that level of 90 per cent. And in fact it was not 90 per cent. All the documentation will indicate that it was closer to 92, 93, 94 per cent, which was a glitch in the computer. That is as an aside. There are many Colonial statements around, and I can see Mr Robert—trust me, it was not 80 per cent; it was 82½, 83 per cent.

Mr ROBERT—In many cases it was 143 per cent!

Mr O'Brien—No, that is negative equity. That is where we ended up. However, this became an Achilles heel when the market did melt down because we essentially, at times, were two days away from being positive, being negative. I mean, a six per cent, two-day slide, and bingo, we are in trouble.

Mr PEARCE—Just to clarify Senator Mason's point: you were provided these updates verbally at an investor update session by Storm?

Mr O'Brien—Yes.

Mr Anderson—If you were not there, you did not get the message.

Mr O'Brien—The updates were, I think, usually run—correct me if I am wrong—by the Cassimatis'?

Mr Anderson—Yes.

Mr O'Brien—They would do a road tour and come down and book a hall somewhere and we were all invited—

Senator MASON—That is extraordinary.

Mr O'Brien—They did not do a road tour just to tell us about something like this. It would be a general update on the market and the situations.

Senator MASON—You are being exposed to more risk and you are not being informed individually. Anyway, we have touched on that and there are plenty of other questions. I will go right to the end of the letter, to the second last dot point. It says, 'In the unlikely event of a margin call, Colonial Geared Investments and Storm Financial will work in partnership to clear the margin call. Note, however, that Colonial Geared Investments reserves its rights under its margin lending terms and conditions in any case.' This 'will work in partnership' strikes me as being nearly the nub of the entire issue. Is that right?

Mr O'Brien—Correct.

Senator MASON—What is the nature of this partnership?

Mr O'Brien—Well, the letter says it.

Senator MASON—You talk about a symbiotic nature and an umbilical connection, don't you?

Mr O'Brien—Yes.

Senator MASON—Do you know of any document other than this that relates to this special partnership?

Mr Weir—In my role as chairman of SICAG, when the bank was active in delivering hardship resolutions to their clients earlier this year before this latest resolution process was negotiated between the bank and Slater and Gordon, we were very concerned at the manner in which they were going about this. We wrote to the head of that hardship process, a Mr Marabani. In his reply to me, he said, 'We draw your attention to a commercial agreement that we had with Storm Financial that enabled us to hand over sole and complete responsibility for the management of margin loans and the calling of margin calls.' I wrote back to him and asked if he could provide us with proof. After extensive and exhaustive investigations I was unable to provide or identify the origins of this commercial agreement. 'Would you provide me with proof? Would you tell me what due diligence you required Storm Financial to undergo to discharge their obligations under the commercial agreement and could you tell me what legal requirements you placed to enable you to be able to hand over and abrogate full responsibility to

those under the law, without Storm being just an agent and having ultimate responsibility?' They failed to reply. I did not get a reply to my request.

Senator MASON—We will have some interesting questions in the future to ask about this.

Senator McLUCAS—Who was that letter from?

Mr Weir—That letter was from Fred Marabani, the head of the hardship team of the Commonwealth Bank. An extract from that letter is contained in my personal submission to the parliamentary inquiry.

Senator McLUCAS—To follow on from Senator Mason's question, you were at the hearing in Cairns on Tuesday. You would have heard the two financial advisers who gave evidence at the end of the hearing when questions were asked about what they did in those days in November 2007 when the market was plummeting. Both of them indicated they had clients that had margin loans, and both of them indicated to the committee that they were monitoring—I think I am accurate in saying this—by the hour where the market was and where their clients were in terms of margin calls. They were not relying on the lending institution to do that. Do you have any idea why Storm did not act on behalf of its investors in the same way?

Mr O'Brien—I believe it gets back to this philosophy of hanging on. How gullible can you be? We were of the belief—'we' being the clients and 'we' being Storm—that the bank was going to stand by us and help us ride it out. Call me a fool if you like. With other companies outside of Storm, their clients were getting margin calls at 80 per cent. We were hearing this through the industry and through contacts. We were thinking to ourselves, 'How lucky are we that we are still in there with a show with Storm.' That is a true story.

Senator McLUCAS—Mr O'Brien, that is not really the question I am asking. What I am saying is that the other two financial advisers who have given evidence to this committee have said that, irrespective of what was happening with the banking institution, as part of their responsibility as the financial adviser to their client, they were ascertaining whether they were in margin call territory.

Mr O'Brien—They were working for another company.

Senator McLUCAS—No, they were financial advisers.

Mr O'Brien—Yes, but they were not working for Storm.

Senator McLUCAS—That is the point I am making. They were financial advisers. One of them called themselves, I think, an independent financial adviser. They said they did not need the bank to ring them up and say that that client was in margin call—they were monitoring the share market; they knew how much their client had invested in various investment entities and they themselves could ascertain whether their client was in margin call.

Mr O'Brien—I cannot answer for them. I can give a suggestion that they probably realised themselves that their clients were getting into trouble and were starting to do the right thing. By way of explanation, I was involved in a discussion with another adviser firm in Townsville the

other day and part of the discussion was that they had 90 clients with margin loans. They realised that the information was so corrupted on the Colonial website that they had to do something about it. So they had a very simple manual spreadsheet that they were monitoring on a daily basis on behalf of their clients. I think they had a client who had been in margin call for something like two weeks and they brought about steps to get him out of that situation. To this day Colonial still do not know that he had been in a margin call.

I guess in a situation where it was very small, advisers could be proactive and take the responsibility away from the bank. Having said that, this particular adviser in Townsville said that in his normal situation it was the bank that would be advising the client. But that system had fallen down. I said, 'How did that happen?' He said, 'By way of an email every Monday morning. We got to the point where we could not rely on the emails because the information in them was of little value.'

Mr Weir—I do believe that those operatives within Storm were not exactly sitting on their hands during that very frantic period that Mrs Cassimatis alluded to this morning. I have seen emails that were sent from Carmela Richards to one of the operatives in Colonial providing a list of names for the next sell down before they went into margin call, making reference to other people that the Colonial-gearred investments would have taken the initiative of selling down before they were in margin call.

I do not know too much about what was going on behind the scenes in Storm Financial, but I know that there was a lot of frantic activity going on. It is probably one thing to say that some organisations with fewer margin loan customers were able to do it manually. But the sheer weight of numbers that Storm had in these circumstances, and the lack of resources, meant that they simply were not able to do it.

CHAIRMAN—Can I just check a fact: you said you saw emails, and they were frantically selling people down?

Mr Weir—They were issuing instructions to Colonial to sell people down before they got into margin call.

CHAIRMAN—Did the people know they were being sold down?

Mr Weir—I think it was reacting to those authorities that we had signed.

CHAIRMAN—It was just to clarify, that is all.

Senator McLUCAS—I accept your evidence about these glitches in the computer. This is 2007 we are talking about, and it is a big glitch. We will talk to the banks about that in good time. Can I point you to line 370 of your submission? Without reading it out, it goes to the question of loan applications being routinely massaged. Can you tell me more about that please?

Mr Weir—That aspect of the relationship between Storm and the retail banking sector is the subject surrounding which the Commonwealth Bank have identified shortcomings in their relationship with their customers and Storm Financial. There has been a filing in the Federal Court against the Bank of Queensland by Slater & Gordon in connection with anomalies in loan

processing, and in their submission to this inquiry the ANZ Bank has also identified that they had difficulties.

Senator McLUCAS—Now I know the genesis of where that is coming from, that will be pursued in another forum. Recommendation 1 of your submission, entitled *Lender liability*—“*A duty of care*” talks about establishing lender liability legislation. This goes to the essence of what this committee is all about, and that is making recommendations to government about what we should be doing in terms of our regulatory environment. Can you explain to the committee how, if we had lender liability legislation in place prior to the end of 2007 that would have assisted in ensuring that what happened did not happen?

Mr Anderson—We are basically talking about the aggressive marketing of lending. You could probably describe some of these banks as mortgage factories. They were sort of pushing the loans out without any sort of due care as to just exactly what their purpose was. Their prudential lending was more or less based on whatever security was available to give the loan, rather than the ability to service the loan. They relied heavily on the actual income from the investments, especially for people who were retirees. You can see the application forms, where they actually say, ‘The income is zero. Independent means.’ On the other side it is actually showing the margin loan as being a commitment but on the servicing side, again, it has got zero.

How can this be? That is not prudential lending. I spent 40 years at the Commonwealth Bank. A lot of the time you were doing people a service to decline their loan. They did not always appreciate it at the time but, generally speaking, if there was a reason why you could not give them the money, you were normally doing the right thing by them. They may have felt hard done by and gone somewhere else to get it. There is not much you can do about that part of it, but for a lot of cases you were doing them a favour. For some of these cases it would be just like giving a personal loan to an 18-year-old to buy the biggest motorbike in town, because you know he is going to go out and kill himself. It is just not responsible. Some of this, I think, is probably the same.

Mr Weir—I would like to make one further point. It has become evident to us that little else figures in the mind of a person considering the serviceability of a loan other than their ability to grab the security if all else fails. That figures prominently, at the end of the day, in whether or not that person should be extended that facility.

Senator McLUCAS—My very last question is one I raised with Mr Dalle Cort on Tuesday and you might want to quickly tell me about this. It goes to line 341 of your submission where you talk about trips overseas. I asked Mr Dalle Cort whether they were sponsored, or funded, by Storm Financial. He indicated to me that people paid their own way. Your submission does not seem to concur absolutely with his position. Can you give me an understanding—and you might not be able to do this, because you possibly do not know—of the value of the sponsorships from Storm, from Colonial Geared Investments and from Challenger that essentially supplemented the quality of that trip?

Mr Weir—It is hearsay only. I had the privilege of going on each of those trips and I can show you my cheque butts.

Senator McLUCAS—But you cannot show me the others, can you!

Mr Weir—There were some what I can only describe as quite magnificent value-added occasions that took place, sponsored by the banking industry. It is reputed that on the Cassimatis' first trip to Canada several hundred thousand dollars of their own money was devoted to the success of the trip. I understand that the second trip, which was to Europe, was funded by the Cassimatis' to the extent of about \$1 million of their own funds. More recently, for a trip to South Africa, a similar amount was supplied to value add on that occasion. I understand that instead of travelling by bus between certain venues they funded air charters.

We were asked to write letters of appreciation to the banking industry following the Canada trip. There was no mention of that following the other two excursions. But, as far as we know, Challenger and Colonial figured very prominently in sponsoring value-added occasions on each of those trips.

Mr O'Brien—I might quickly add that economies of scale presented themselves. For the first trip, 150 people went. For the second trip, which we went on, there were 300 people. That was due to word of mouth. Then for the last two trips I think there were a couple of hundred on each. We were all put through travel agencies, and we all received upgrades because of the number of people involved. We went through a Townsville travel agency. They sent out the brochures and we paid accordingly.

Senator McLUCAS—Thank you for putting that on the record.

Mr PEARCE—I have a couple of quick question; I am conscious of the time. You represent a lot of Storm investors, some 1,500 or so at the moment. I know that each is unique in their own right, but could you tell me, on average, within your knowledge of Storm investors, from the time the investor became acquainted with Storm how long would they typically go before they became a client of Storm's?

Mr Anderson—A hundred and eighty days is the number. Really it was like a cooling-off period. The average was around that. I think I spent more than that length of time.

Mr PEARCE—That is true, is it?

Mr Anderson—Yes, it is a fact. I do not know why we will not accept that.

Mr O'Brien—It was not a daily interrogation. Remember I am coming from an older relationship that was eventually taken over by Storm.

Mr PEARCE—I understand.

Mr O'Brien—It took my darling wife and I quite some time to consider the changes. But for new people coming in, they may go to a seminar and then not come back for three or four months. They would go back and talk to their families. So it is possibly a legitimate suggestion that it did take that long from day one to eventually becoming an investor.

Mr PEARCE—Okay. Mr O'Brien, earlier I think you said something along these lines, that you knew that the bank had lent you the money. I want to get to this question about who you felt you were dealing with. Do you believe that you as a client of Storm had a direct relationship

with the bank, which bank that may have been, or were you a Storm client? What was your view on that?

Mr O'Brien—I was a Storm client and if I wanted any information regarding my loan I would go through my adviser, who could more quickly access someone within Colonial. We are talking about the margin lending. Our retail loan was with another bank. If I wanted any information regarding it, we would have a regular quarterly statement that would come out.

Mr PEARCE—But did you deal with the bank? Did you talk to the bank?

Mr O'Brien—No.

Mr PEARCE—Did you ever meet people at the bank?

Mr O'Brien—No.

Mr Weir—That is a unique characteristic of margin loans, though. Margin loans are secured by equities. They do not really look at your assets or liabilities, they know it is going to be secured, and even your ability to repay does not figure because on a lot of occasions the interest is capitalised anyway. It is an accepted part of that product. As for an across the desk interview for a margin loan, it is unheard of as far as I am concerned. You filled out a pro forma page at the back of a prospectus or a product disclosure statement, and that was a dual document that gave you your investment in equities and the associated margin loan that went with it. There was no such thing as a formal face-to-face interview in the process. Maybe if there is going to be stiffer regulation regarding those products it needs to be looked at. But I think the fundamental principle was that it was going to be secured by investment in an equities trust with appropriate pitching of the LVR levels. That was the protection of the lender.

Senator WILLIAMS—Mr Anderson, can I thank you and your organisation or group for the moral support you have given to a lot of people. I think you have done a magnificent job. The audience applause backs that up. You were with the Commonwealth Bank for 40 years. You obviously are a very experienced bank officer. I would take with that you are an intelligent man and you have seen a lot about the banking and finance industry. If I were to paint a hypothetical picture to you to say tomorrow you are running Australia and you can change some rules, what rules would you change to see that this sort of action never happened again?

Mr Anderson—I really think the one-stop shop of Storm, that people walked in the door, they gave the financial advice but they then had the ability to organise an investment loan for you and a margin loan for you. I think there has got to be a total separation of those roles.

Senator WILLIAMS—Righto. So you would look at financial advice and financial planning and how it is distributed to the people? That would be one issue?

Mr Anderson—Yes. It was just too cosy an arrangement. We saw it as being very convenient, but in reality that has been the total downfall because there was a huge conflict of interest. People were giving their information to the financial person. They were doing a profile on a computer disc. They were then sending that to the various banks to get a quote for the business. I have not seen my disc—I beg your pardon; I tell a lie. I have. It arrived in the mail only the other

day from KordaMentha. The information on there was current at that particular time, but over time things changed. When I first made the application for a margin loan to get into the Storm part, we looked at it for several months, because borrowing money to get into the market was totally against everything that I had grown up with. However, over time we came to accept that part of the deal.

I was not investing in Storm Financial; I was investing in Colonial First State. That was the Commonwealth Bank, which I had worked for for 40 years. I totally trusted the bank and Colonial First State. I knew who had set up the thing. I even went to my own financial planner in my branch and said, 'Can I buy this product through you rather than go through Storm, because I won't have to pay the seven per cent?' 'Sorry, Graham. Can't do it.' The reason he could not do it was that it was exclusively badged to Storm Financial, so obviously this product had been set up by them exclusively for them. If the Commonwealth Bank or Colonial First State is going to have a product which is exclusively for this particular client, they must think they are a fairly good sort of operator to be able to do that for them. That is huge. I was investing not in Storm but in Colonial First State.

I was getting a range of stocks which were over the whole ASX 300. They actually had caps on some of those because it was not in the same percentage as what the market is built up with, because they will not have you with too much exposure to AMP, BHP or some of the bigger players. So it was balanced. That gave one confidence that it would happen. The plan that they gave to you actually had built into it interest rates increasing, so you might only have been paying six per cent for your loan but they had it worked out as if you were paying 10 per cent. On the other side, they actually showed that the returns you were getting on your money were not five percent; they were down at three per cent. They were also showing drops in the market. So that made one feel confident that you could be stress tested. I think that when we hopped into it our LVR would have been less than 50 per cent, so when the market went up it looked fine; we still stayed within that margin. It was only at the end of the day, when everything went wrong, that we ended up in negative equity. But I honestly believed when we signed those bits of paper in October to do the sell down to put us into cash that it was doing the right thing.

I do my banking on my internet. I looked at my accounts there and said, 'Oops.' There was a cash accelerator account that had been opened in my name. When I looked at it there was almost \$600,000 in it. I thought, 'Oh, they're doing the right thing by me.' A few weeks later I looked there and there was almost \$1.8 million in it. I thought, 'Jeez; they've salted away a hell of a lot more.' So I thought they were doing the right thing and keeping me safe. When I got that phone call on 8 December, I almost fell out of the chair. I just could not believe what I was being told.

Senator WILLIAMS—What did the phone call tell you?

Mr Anderson—'You're in negative equity. You're gone.' So my life savings had just shattered. My superannuation of some \$800,000 and half of my house had just gone down the chute, and I was not told. It was like that for everybody. Had I got a phone call when we were at 80 per cent, I would have had the option to make a decision, but we were not given that option. The product disclosure brochure says clearly in black and white, 'We will advise you in writing that you must do this within'—whatever the time is—'and, if you haven't done it within five days, we will do that.'

Senator WILLIAMS—Who was ‘we’?

Mr Anderson—Colonial—their terms and conditions brochure. But, when you turn over to page 24, it says, ‘We don’t have to do anything.’

Mr ROBERT—Mr Anderson, why didn’t your Storm adviser call you when you had hit that 80 per cent mark?

Mr Anderson—I do not believe he knew when we had hit that 80 per cent mark.

CHAIRMAN—But hadn’t you already been informed of the 80 per cent previously at a meeting?

Mr Anderson—No, the buffer, not the LVR. They are completely different in terms of—

Mr ROBERT—Mr Anderson, how can your financial adviser not know when you have hit it? Their job is to provide you financial advice. You pay him an ongoing trail commission to maintain a watching brief. So how could someone you are paying to have a watching brief not be watching?

Mr Anderson—I assume what they were watching was not giving them the information. We have heard enough evidence to say that the information that was coming through was incorrect.

Mr ROBERT—Granted, but they would know exactly. If you have got \$2 million worth of action, they would know that. If you are at 80 per cent LVR they do the maths quickly. But you are in an ASX 300 which follows the all ordinaries almost exactly on industrial resources.

Mr Anderson—Yes, it is pretty close to it.

Mr ROBERT—So they could actually just watch the slide. When the all industrials or resources closes 20 per cent down, or 18 per cent in one week, then that has slipped against your LVR almost 18 per cent. It is very simple maths. How could your adviser not do that simple maths to keep you advised?

Mr Anderson—I cannot advise you on that, but when they did sell down to cash—that cash that went into that accelerator account—then it was at 100 per cent borrowing. So that actually increased where you were at. It gave you that bit more of a buffer. So I cannot answer that, but—

Mr ROBERT—In holding a financial licence it is a requirement that a range of things occur.

Mr Anderson—Yes.

Mr ROBERT—And if your financial adviser is not doing that range of things then I would have to suggest there is a problem.

Senator FARRELL—Thank you for coming along, gentlemen. In your summary you give the committee some information about the age bracket of the Storm investors. You say that a

majority are either retirees or approaching retirement. Can you break that down a bit more? Is it more than 50 per cent of the people who invested in Storm that—

Mr Anderson—It is closer to 80, I believe.

Senator FARRELL—80 per cent were retirees?

Mr Weir—I think our attachment with the results of our survey might outline that. I thought we contained that in our submission actually.

Mr Anderson—We surveyed our members and tried to break down those that used their—

Mr Weir—The breakdown of age sectors are shown below—30 to 49 years: 22.7 per cent; 50 to 59 years: 29.5 per cent—

Senator FARRELL—Yes, I have that. But I am really querying whether you can tell us exactly how many were retired? Do we make some assumptions that anybody over 60 is retired? The question I have is whether or not this particular product was ever going to be a good product for a person who was retired or retiring—whether you should ever offer this product to somebody who is looking at retirement? Has that question crossed your mind?

Mr Weir—It is a fair question, but wisdom in hindsight is a magnificent instrument and I guess that if I was going back into a geared leveraging strategy at the present time I would go back in with a great deal more insight and wisdom. As I have said to the fellows, as a result of our exposure over the last eight months we will come out with all the answers but nobody will want to ask us the questions.

CHAIRMAN—Hopefully you can tell us all your answers in here. That is what we are here to do. So we will be using your information.

Mr O'Brien—As we have to wind-up, I would like to give a closing summary. I apologise that in the first little section I will be referring to me personally. It is not about me, it is about SICAG; but I think I am probably Mr Joe Average so I have used me as an example.

CHAIRMAN—That's fine.

Mr O'Brien—I thank the committee for granting us the privilege to appear before you today and await the outcome of your deliberations with interest. I appear today not just as a representatives of a group of some 1,600 Australians whose financial security was snuffed out earlier this year but also as a victim of the Storm debacle myself. I naively trusted Storm and the banks to look after me. When the share market got the staggers late last year and the global financial crisis hit this country I was wrong and I am now paying dearly for my misplaced faith. The numerous inquiries into this national disaster will eventually tell me who was to blame for the financial damage done to me and others and maybe, just maybe, there will be some restoration of my lost assets.

However I can say here categorically today that nothing will ever restore my faith in the Australian banking industry. As a client of Storm, the yellow and black logo of the

Commonwealth Bank gave me courage and confidence that I had the implicit backing of Australia's biggest bank. Storm's partnership with the CBA allowed me to sleep at night, a luxury that I have not enjoyed now for eight months. I was proud to tell my family and friends that our money was safe because Storm had the backing of CBA, Australia's biggest bank. Many O'Brien family members and friends trusted my judgement and also put their money into Storm. I do not think that you can imagine how difficult it is for me to look these people in the eye after the events of December 2008.

We all made the mistake of expecting Australia's biggest bank to stand shoulder to shoulder with us in our hour of need. Australia's banking industry is the envy of the other developed nations. The major banks are aptly known as the 'four pillars' because they underpin our nation's economy. This was made clear earlier this year when our Prime Minister and Treasurer used taxpayers' money to shore up the banks during the worst of the credit crisis. We ordinary Australian taxpayers stood by the banks during their hour of need. Surely it was not unreasonable to expect that the banks would do likewise in our hour of need.

Mr Chairman, you and your committee have a hard, hard task. We understand and we respect that. However I believe it is becoming obvious in the course of this inquiry that this is so big that the banking industry needs a complete overhaul before Australians will fully trust their banks again. I respectfully take this opportunity to urge you all to lobby your parliamentary colleagues hard to convince the federal government to undertake a new, broader inquiry into the Australian banking industry itself. At the very least we need plain English documentation common and to all lenders, legislated lender liability, a legislated code of banking practice, and a body with teeth to oversee the industry. That can only happen if you can generate the political will to fix the core problem that led to the collapse of Storm—and by the way, the Storms of this world will come and go but the banks will continue to be there—a combination of reckless lending and cold, unconscionable behaviour in abandoning customers in their hour of dire need. It is probably too late for my generation to regain its faith in the banks, but let us leave a better banking environment for our children and grandchildren. It is the right thing to do.

CHAIRMAN—Gentlemen, thank you very much. We really appreciate everything that you have done and your representation of all the people involved, all the investors, and we appreciate your time today as well. Thank you very much.

[2.53 pm]

JELICH, Mr Radomir (Ron), Private capacity

CHAIRMAN—Welcome, Mr Jelich. Do you have any comments on the capacity in which you appear?

Mr Jelich—I am here as the former national development manager for Storm Financial and managing director of Storm Financial (Five), which was the old Jelich Jones business.

CHAIRMAN—Would you like to make some opening remarks or a statement to add to your submission?

Mr Jelich—I gave the committee an initial submission and a supplementary. I also have further information that I have not had time to table which I would like to live with the committee. It has come to light since the last submission was made. I am going to do my very best today to do whatever I can to provide you with the information that I have, to ensure that this nightmare never occurs again, and I am also going to do my very best to provide you with information that may be helpful in providing restitution for ordinary, innocent, honest Australians who did nothing wrong other than trust us. As hollow as it may sound, I do want to publicly apologise to the people who have been devastated by this event. With that said, I want to give you a little bit of background.

I started in this industry in 1982 in a little place called Redcliffe, where I started building a business. It soon became apparent that the business was growing, it was attaining some level of success, and from an early stage I felt extremely thankful and obligated to three major players. One is the industry that I am in, another is the community that I live in and the third are the clients and the people that I acted for. To this day, I feel that the people in those three categories have given me more than I have given them. So I have felt deeply obligated to repay, to the extent that I can, my industry, my community and the clients. Others can judge whether that is just words or whether there were actually actions behind that.

In 1991, Bob Jones joined me. He was a personal friend and a man of high integrity, and we started the firm Jelich Jones. We were very passionate about Redcliffe and were deeply and intimately involved in our community in a meaningful manner. Whether it was sporting associations or business bodies, we involved ourselves in the community and wanted to contribute in every way possible.

CHAIRMAN—Mr Jelich, sorry, I do not want to interrupt you. I am just conscious of the time. We really appreciate your involvement in the community—

Mr Jelich—Please, just indulge me a little longer.

CHAIRMAN—Sure.

Mr Jelich—From a business standpoint, financial planning has become quite a complex matter. But the success or otherwise that we had over a 25-year period—that is, from 1982 to 2007—was founded on five basic principles, and I will quickly run through them. You can question me on them a bit later on. I would preach these five principles to anyone who would listen throughout my life.

Firstly, before I acted for a client, I always needed to ensure that we set clear goals, because if you do not have clear goals it is highly likely that you are not going to achieve what you are after. In order to do that, I maintained that homeownership was the primary goal of every individual, particularly early in life. So in many instances I would spend meetings solely on homeownership, particularly if they were young, and on the importance of that and what it meant in a financial sense. Secondly, I always tried to preach the importance of keeping cash reserves for rainy days. I just felt that was a requirement of sound management.

Thirdly—though it was difficult to articulate to people and took some time—my belief was that an individual, in this day and age, to achieve their financial goals needed to borrow some money at some point. Fundamentally, and philosophically, I believe you do need to borrow to achieve financial goals. The issue of how much to borrow and whether to invest it in your own business, into property or into other the asset classes is a separate matter. But it was a very difficult psychological burden for people to overcome: the fact that they had to borrow.

Fourthly, we always maintained that people should stay with quality. So if they were buying property, you wanted it to be in an area you were familiar with, that you knew a lot about, and one that, over time, would grow. If they were buying shares, there was a philosophical argument about direct stocks, actively managed funds, hedged funds or—and in my view this was the safest way to invest in the equities market—indexing. Fifthly, we advised: ‘Always ensure that your superannuation is managed correctly.’

So it was those five points generally that I preached, and I would like to think that, though others can judge whether, that ensured whatever success we did achieve during that 25-year period. And of course I made absolutely no bones about the fact that the goals had to be clear, they would change through the various stages of life, and there was going to be hard work involved. Rightly or wrongly, I am very proud of some of the work we did during that period in assisting people to achieve the goals that we had set, which, in many cases, took over 20 years.

The relationships I had with people were very important to me. I always wanted to be loyal to people. I wanted commitment from them and I wanted them to trust me, and that could only happen over time. I also want to stress that I derived enormous satisfaction from the many positive results we got over a long period; it was a form of sustenance for me that I really felt good about. Indeed, it was a privilege to act for people.

In that context, the only way that I can describe the last nine months, starting in October, is to use the word ‘holocaust’. That is the only word I can think of that describes what has occurred. I feel deeply responsible on many levels—to the clients, the community and the industry—for the holocaust that has occurred. But I also deeply feel responsible for the regional offices I brought into the Storm fold all over Australia and to their staff, but mainly, of course, to the clients that did trust us.

I want to touch on the reality of how this holocaust has manifested itself. I am personally unaware of any suicides—none have been confirmed to me—but on every single day since January, I can vow to you, I have spoken to somebody who has contemplated suicide seriously, or who is contemplating it as we speak now and has displayed suicidal tendencies. There have been severe strains on marital relationships. Healthy people have had cardiac arrests. There has been loss of dignity and self worth; severe depression; and, as Noel O'Brien alluded to, a tremendous breach of trust, leading to a suspicion of people generally, including betrayal.

When I think about the people who spoke before me, it brings me down to my knees and I feel very emotional. I will never be able to thank them, because in January I was in a psychiatric ward and these three gentlemen put their own needs aside and somehow garnered forces and gathered what was left, and they have formed a point of contact and a focal point that has given people a place to vent their anger and to achieve some level of comfort. Without them I am not sure that we would be here today.

I will put this in chronological order. In March of 2007, I made the worst decision of my life in a business sense. That is, I sold my business to Storm Financial, hence being one of the larger creditors to the failed company now. It was a decision that was not taken lightly. It was a decision I did not want to make, but I did sign the contract. We were very parochial in Redcliffe. We were proud of what we had done. We controlled the revenue—certainly for our patch—and we held sway about what the clients' tailoring of investments would entail.

Despite assurances to the contrary post sale, complete control was moved to the central office. All of the revenue went to the central office, and the input into client manufacturing of advice was taken from us and allocated to the central processing cell. That was strict company policy and, in my humble opinion, from March of 2007 the welfare of the clients was overlooked for an obsessive desire to publicly list Storm Financial. The complete, obsessive focus was on fee income, I assume to satisfy analysts' expectations. A number of times it was said, 'We own you. You will do what you are told,' and I have some evidence here of some recharges that were charged back to my office.

In December of 2007, a prospectus was issued to list the company publicly. After digesting and seeing for the first time the IPO offering, I went into a fuming, uncontrollable rage, because I saw nothing other than a corporate heist by the founders. I sought advice from mentors and lifelong friends whom I trusted deeply. Those people included the Australian cricket coach, John Buchanan, for whom I have very high regard as a deep thinker and someone who would give me wise counsel; Dr Phil Jauncey, who is a personal friend, an internationally renowned psychologist and someone for whom I have a lot of respect; and also John Gibbs in Sydney. They advised me about what to do with what I thought was a corporate heist. They said, 'Settle down. Get some legal advice'—which I have done and I have got evidence here that I sought from McCulloch Robertson about extricating myself from the company. The upshot was that I decided to stay, for two reasons. The first reason was: my whole world was now involved with Storm—from my mother, to my immediate family, to my extended family, to the people of Redcliffe, to the external advisers. If I were to leave, where I was I going to go? It was my world since 1982, since I was 21 years of age. So it was impossible to walk out on that scenario.

The other reason which had a big bearing on my staying was, 'Boy, this is wrong, but at least we have got the backing of the Commonwealth Bank on a number of levels.' They manufacture

our funds, they provide our retail lending, they provide our margin lending, they do our insurance and they hold our corporate finance. So I had a lot of faith in the major supplier of goods to us, which I thought would keep us in good stead.

I want to reiterate how upset I was during that period. I went for at least a six-month period—probably closer to nine months—subsequent to the failed IPO, where I did not speak to the founders. I can give you details later on if you want me to about why I felt that way.

On 10 October last year my stomach turned because I knew the company was in trouble. In fact, I knew the economy was in trouble because it was a Friday and the market had fallen below 4,000 points, so you did not need to be a Rhodes scholar to know that we were in trouble. Mr Rudd guaranteed all bank deposits two days later—I believe it was on a Sunday afternoon—and I think that it showed the seriousness of what was going on in the world at the time. But I do remember sighing to myself and thinking, ‘Thank God we are with CBA.’

Another critical date that I think is important in the overall examination was a meeting that was convened on 7 November in the Storm offices in Brisbane, where all the regional advisers were hauled in very quickly. The CFOs were there and said: ‘We have a minor accounting issue. We need to extend the money we owe you by a year so that the balance sheet takes the loans off our current liabilities and put them onto long-term liabilities.’ It was conveyed to us that the reason for this was so that we could continue to assist clients with funding during the downturn to the tune of \$350,000 to \$400,000 a month. It was to help us secure extra funding from the Commonwealth Bank. We were told that there was \$17 or \$18 million in the bank at that time and, more importantly, we were told by the founders that the company had enough capital to trade for another 18 months without any further revenue. So, during a difficult period, that was music to my ears, and I went back to my stakeholders, including staff and clients, and said, ‘Hey, we are really battling here but we are going to be on our feet for another 18 months. Come what may, we have got enough capital to get us through.’ Those documents were immediately signed that afternoon by the stakeholders. It was done in good faith based on the information provided to us at the time, and it certainly formed the basis for some of the personal decisions I made subsequent to that.

On 1 December we had an email—which I had here but it did not have prior to submitting my submissions—that a joint task force had been set up between the CBA and Storm. Again, it was music to my ears that we were working together with our key ally to address the issues.

On Monday, 8 December, I knew the death knell had rung. The Commonwealth Bank, with pre-scripted calls absolving themselves of any guilt, starting calling our clients directly. I just knew that that was not part of what I was told a week earlier about there being a joint task force working towards a resolution.

On 9 December the bank, in their wisdom, reduced the ratios from the mid-90s back to a 70 per buffer and an 80 per cent margin call. That left hundreds of people stranded where they were really locked away in no-man’s-land with no chance of recovery.

On the 10th, the Commonwealth Colonial First State funds were shut down completely, irrespective of whether they had any level of lending attached to them at all. On the 11th and the

12th, the headlines in the *Townsville Bulletin* were ‘CBA pulls plug on Storm,’ and it was all over.

I want to accept responsibility for my part in this holocaust. But I believe that the bank needs to be condemned for its malicious, swift, pre-orchestrated and brutal decisions that ultimately led to the disaster that we find ourselves in now. They had a complete disregard for their customers. They were an institution that I was very proud to have been involved with for so long and they were an institution that had received Mr Rudd’s government guarantee, which was funded by taxpayers, only a couple of months earlier. I have some other points here. I can keep going if you like, or take some questions.

CHAIRMAN—Mr Jelich, we are really thankful. You have provided a lot of information, and we have your submission. In the next 15 minutes, we might use your experience and knowledge to get a better understanding of what took place and what went wrong. What convinced you to join Storm? What was the big sell?

Mr Jelich—The back office. They had a fantastic compliance regime. They dotted the i’s and crossed the t’s. That was very attractive to Bob and I.

CHAIRMAN—As you have described it, your business was vastly different—almost diametrically opposed—in terms of the type of belief structures that you had, systems that you used and advice that you provided to individuals.

Mr Jelich—Not at all.

CHAIRMAN—No?

Mr Jelich—No. The success of our business was based on the five parameters that I have outlined, which did include a fundamental belief that borrowing is required to achieve financial goals.

CHAIRMAN—You talked about the IPO listing, and you said that you saw it as a corporate heist. Can you elaborate? What so offensive about the IPO and the documents that you saw that changed your views?

Mr Jelich—I was not privy to any of this information until the prospectus was issued. I will go through them in no particular order. The regional offices that were bought by Storm represented eight per cent of the projected market capitalisation. The regional offices, in my opinion, would have accounted for more than 50 per cent of the revenue of the entire company. I thought that that was a gross inequity in share distribution relative to what the revenue that it would generate. That is the first thing. The second thing is that the founders chose to retain 53 per cent and total control of the company. The founders chose to put \$40 million in their pockets the minute that the company listed. There were royalties, licensing fees and other payments made to a company called Ignite from the listed entity, which was 100 per cent owned by the founders. I did say in no particular order. The list price, according to the prospectus was a lowball figure of \$425 million to \$500 million and the founders would not budge off those numbers. Those are outrageous values for a company of our size that I had quite a bit to do with that.

Mr ROBERT—How many times EBIT was that?

Mr Jelich—Maybe 15 to 20.

CHAIRMAN—Would you say the fees and charges you read in the documents meant it was very difficult, given all those fees and charges, for you to return a profit to your investors or to yourself?

Mr Jelich—No, my objection was to the large lick of the pie that the founders chose to take off the table initially. Then they retained 53 per cent, even after the public offering, whilst the regional officers who produced a huge amount of business—I am guessing in excess of 50 per cent—were allocated eight per cent equity in the total vehicle—in addition to royalties, commissions and fees paid to a separate company owned entirely by the founders.

Mr PEARCE—I have read your submission. In addition to selling your business, you assumed a position in Storm. Could you outline to the committee what your job was?

Mr Jelich—In addition to selling the business in 2007, in 2003, when we moved the licensing to Storm, I took on a national development role. It was my job to bring on new advisory groups under the Storm model.

Mr PEARCE—How did you do that?

Mr Jelich—I had had 25 years in the industry at the time. I had a lot of colleagues, a lot of friends and a lot of people who I had contact with during that period, and I approached them about the opportunities that Storm offered.

Mr PEARCE—In your opinion, what was the major reason behind Storm's collapse?

Mr Jelich—I will pinch a word from Justice Logan's findings in the Storm Financial v ASIC case in, I think, March this year, and that is the word 'chimera' that Justice Logan used in relation to the Cassimatis testimony in that hearing. I had no idea what a chimera was, but I looked it up in a dictionary and it said it is a 'fanciful mental illusion or fabrication; a wild and unrealistic dream or idea'. One of the predominant reasons Storm failed was that it did not have the cash reserves and cash backing it had purported, to me certainly and to many others, to have. Terms like 'a very strong balance sheet', 'low levels of debt', 'a war chest of cash reserves', 'the essential need to grow cash reserves before you grow your business' were impressed upon advisers and staff, leading us to the belief that there was a war chest available, a lot of money—as any business should have—at least to trade, as was mentioned in early November, for 18 months. Less than a month after that, I was horrified that two months of poor income, from October to November, meant there was nothing there; the company was insolvent and it could not pay its tax bill. As quoted in the press, the management of the company was reckless and irresponsible because it had a duty to a number of stakeholders to have that money put aside for rainy days, but it simply was not there. It destroyed me.

Mr PEARCE—I am interested in the discussion about who had the responsibility for the client. We have received conflicting evidence about this issue. The committee has been told that

in some cases the relationship was between the client and Storm, while on other occasions we have been told that the relationship was between the client and the banks. Can you offer a view?

Mr Jelich—It was definitely between the client and Storm. Within that there are product providers with every firm. Whether those product providers provide platforms, insurances, investments or shares, the relationship is between the adviser and the client, with products provided by certain parties.

Mr PEARCE—But are you telling the committee that in your view, and given all the experience you had with this organisation, the responsibility for managing the client, looking after the client, was with Storm?

Mr Jelich—Absolutely. Yes.

Mr PEARCE—We have received some evidence that suggests to us that Storm had a model where they actually wanted to manage all of that relationship. In fact, we have received some evidence that suggests to us that that was the way Storm operated—that they preferred to be the entity talking to the client and they preferred the banks to be behind the scenes. Do you support that evidence?

Mr Jelich—It is my understanding—and I understand it to be fact—that the relationship is with the adviser and the client. For example, if you want to use a builder, the builder and the person he is building for have the relationship. The builder then uses subcontractors to perform certain tasks. So we had a number of subcontractors, if you like, who performed certain tasks in order for us to perform our functions.

Mr PEARCE—There have been reports in the media in various forums that that sort of process extended to staff members of Storm actually completing documents on behalf of clients and submitting the documents fully completed to an entity like a bank. There have been many clients of Storm who have said that they had no relationship with the banks, that it was all done by Storm. Was that your understanding?

Mr Jelich—My understanding was that information would be collated in a regional office and—on a compulsory basis—had to be sent to the central Storm cell for processing.

Mr PEARCE—What does ‘processing’ mean?

Mr Jelich—Analysis, manufacturer advice, tendering for loans—the manufacture of whatever needed to be done for any individual had to leave the regional office and go to the central base.

Mr PEARCE—I have one more question. Given your experience in the financial services industry, you would obviously know the Corporations Act well. In your view, given your experience, were the requirements of the Corporations Act maintained within the organisation in which you worked?

Mr Jelich—Up until 10 October, I believe they were.

Senator McLUCAS—Thank you for your submission and for your testimony. That is the issue I would like to pursue with you. You may have heard my questions to Mr Cassimatis this morning about his responsibility as a licensee under the act. I asked him how he recruited people and his answer was ‘they came to us’, and that is a reasonable thing and I think that might have been your job. Am I right in saying that?

Mr Jelich—Certainly, from late 2003 it was.

Senator McLUCAS—That is reasonable. What processes were in place once you had identified other agencies—mostly MLC agencies, as I understand it—to join Storm? What processes were there to ensure compliance with the Corporations Act, in a large organisation like Storm, that ensured that the responsibilities of the licence holder were put into place with respect to the responsibility of the representative? It is a process question, Mr Jelich.

Mr Jelich—There were separate divisions and one was a compliance cell. Nothing would fall through the cracks in that cell. There were checks and balances to look after that area that I would say were tighter than those in other firms I was familiar with.

CHAIRMAN—Was that to protect clients, or was it to protect Storm?

Mr Jelich—The question was about what processes were used.

CHAIRMAN—I know, but I am asking you an additional question. Was all the compliance focused at protecting Storm or was it focused at protecting the investment of the clients?

Mr Jelich—I would say both.

Senator McLUCAS—We spoke to other people who were formerly in the compliance section and my understanding—and I may be wrong—is that the compliance section was looking more to the accurate delivery of the paperwork involved in an application for a loan et cetera. Can you assure me that in the compliance section there was a section that ensured that its representatives were adequately trained and competent to provide those financial services? It is a human resource management question, rather than a financial compliance one, in terms of the application process and everything being ticked off et cetera.

Mr Jelich—I believe there were sufficient human resources to address the issue you are asking me about. Sadly, looking back, I am not sure that there were sufficient human resources post 10 October last year at the Storm end, my end, and the banks’ end. That is a separate issue, but certainly I was of the opinion, and had been told by Emmanuel Cassimatis many times, that ASIC had told him after compliance checks that Storm was the envy of the industry and ASIC wished other firms were as compliant as Storm was. So I had no reason not to think that the checks and balances in the compliance cell were extremely well run.

Senator McLUCAS—I am not sure that we are talking to the same question.

Mr Jelich—I am sorry.

Senator McLUCAS—But I am going to have to stop there. Thank you, Mr Jelich.

Senator WILLIAMS—Would I be correct in saying you did not have a very good relationship with Mr Cassimatis when you were with Storm?

Mr Jelich—Until March 2007, it was a marriage made in heaven, with the benefit of hindsight, because I had a bit of pull. I had my own revenue from the Redcliffe office, and I was making money on the national development side. Whilst we would argue about many things, the relationship was very good and on occasion he would listen to some of my thoughts and beliefs. Post March 2007, it deteriorated dramatically because in no uncertain terms I was told: ‘We now own you. This is company policy’ and, despite what people may think, there was no authority for me at all to even write out a petty cash cheque, or to have input into the specific client plan recommendations. It was company policy to shoot it off to Townsville. Yes, it was testy. It was very good until March 2007, but post that it deteriorated and I was very close to leaving.

Senator WILLIAMS—You have obviously been in the finance industry for a long time, since 1982. I have asked everyone this question. Whose job was it to notify the borrowers, or investors if you want to call them that, about the margin call?

Mr Jelich—Mr Ripoll, I have some information here that I am going to leave with the committee. Can I quickly run through the headings?

CHAIRMAN—No. It is not that we do not want you to do so, it is just that if you do it will take too long and we have other people waiting.

Mr Jelich—In answer to your question, the information I gave ASIC took one day and a half to photocopy. It was a lot of information. But what I have done here is peel everything out other than what is related to margin lending. I respectfully ask that the committee have a look at it. I think you will find some answers in that document. Unquestionably, I received margin calls on behalf of clients from CGI in 1997, 2000, 2001 and 2003. I am not sure why there is this debate as it has always been the responsibility of the margin lender to make the call. The evidence in that dossier will support that.

Senator MASON—Mr Jelich, you said something very interesting on page 9 of your submission under the heading ‘A cosy relationship.’ You said:

Emmanuel Cassimatis and its lenders, particularly the CBA (specifically Colonial Geared Investments) enjoyed a seamless, very close relationship. The intimate relationship was very rewarding for both parties and in my belief led to a relaxation of prudential standards and “creative” handling of clients’ paperwork in relation to asset valuations and loan applications.

You then gave examples: favourable contract terms—in other words, higher LVRs and buffers; Andrew Symonds, the test cricketer; a gala ball in Italy; loans to Storm employees; and ex-CBA employees working for Storm in Townsville. Then you mentioned a VAS computer valuation system. That linked Storm and CBA. Was any other bank given that sort of access?

Mr Jelich—I have since learnt from the CBA in Townsville that VAS was not exclusively used for Storm; it is a national valuation tool used by everyone in the Commonwealth Bank. Whether other banks use it or not, I am not aware.

Senator MASON—We have to move on, but, in essence, they are all examples or indicia of a cosy relationship that could have led to a relaxation of prudential standards, yes?

Mr Jelich—Yes. I would like to say that I was very proud of that relationship for a long time. My relationship with Paul Johnston, who was the CGI national head, dates back to 1996.

Senator MASON—It had benefits for people, including the LVRs being higher and so forth. But, in the end, it was a two-edged sword.

Mr Jelich—I have not only been privileged to expand the Storm brand nationally; I also had visions of taking it to India and to New York City. I had flown executives from New York to here to look at it. I went to India last year looking for opportunities to expand the business model and the brand. But one of my key selling points was the strength of the relationship with Australia's biggest bank. They manufactured our products, they did the insurance, they did the margin lending and they did the retail lending. It was something that I had a lot of pride in.

Senator WILLIAMS—Was there a situation where either Storm or the Commonwealth Bank raised or realised the increase in the value of assets for clients and then one contacted the other to encourage more lending and more gearing? Do you know anything about that? I was told that the CBA raised the value of houses, for example, and then notified Storm, saying, 'These clients now have more equity if you wish to approach them to borrow more money.' Do you know of anything like that happening?

Mr Jelich—Yes, I do. It coincided with the shift post March 2007 where there was this insatiable thirst for fees.

Senator WILLIAMS—Who raised those values? Was it led by Storm or was it led by the CBA?

Mr Jelich—I am unsure, but it was a mutual arrangement to regularly revalue properties in certain areas with the objective of extracting loans against higher values.

Mr PEARCE—How was the revaluation done?

Mr Jelich—It was explained yesterday by the CBA employees in Townsville. There was a computer system that they punched some criteria into, including postcodes, and they would use whatever came up on the computer as the valuation that was acceptable.

Senator WILLIAMS—And then they would contact Storm to say there was more equity with these customers?

Mr Jelich—Yes, that is correct. If it is appropriate, I also want to apologise to the CBA employees in Townsville that were sacked recently because it had been purported in the CBA submission that they were in breach of company policy and that they were dismissed for that reason. I have learned this week that in fact all of the Storm files held by the CBA in Townsville were audited by the very top of the CBA in February, and congratulations were passed down to the CBA people because they passed muster with flying colours. This simply leads to the point that the policy was wrong and the staff were acting according to the guidelines they were issued

by senior credit people, which is alarming. They have since changed those policies in recognition of the fact that the policies were wrong.

CHAIRMAN—Mr Jelich, thank you very much for your evidence and your submission. You have just handed over your private and confidential dossier. The committee will look at it, make a decision and return it to you.

Mr Jelich—I want to thank you all very much for allowing me to appear. You have heard about a lot of tragedies. I plead with you to do whatever you can to ask Mr Norris, Mr Clothier, Mr Phelps and Mr Kamal Aranout—who I have a high degree of respect for—from CGI for their version of events for that nightmarish period from October to December last year. Thank you very much.

[3.44 pm]

McARDLE, Mr Sean, Private capacity

CHAIRMAN—Welcome. Please make your statement.

Mr McArdle—I have had massive losses realised by the Commonwealth Bank through inappropriate actions. I have prepared an eloquent and wonderful speech to give you but, given the time considerations, I think I will cut straight to the chase. I implore all members of the committee to get hold of Mr Tony Fitzgerald QC's royal commission report into the Queensland Police Service. Do not bother reading the whole thing—you will find out that all Queensland police were dummies and that there were problems with the police service—but I implore you to read the introduction.

The problem with the Queensland Police Service, as identified by Mr Fitzgerald and by some diligent reporters from *Four Corners*, was one of institutional corruption, where there was a systemic problem within the culture of the Queensland Police Service that led to inappropriate alliances and inappropriate actions. Read the introduction and everywhere that you see 'Queensland police' slot in 'bank', slot in 'financial planner'. You could take that document and drop it on the Hon. Mr Rudd's desk and I fail to see how he could not understand what has gone wrong in this situation.

I mean no disrespect to the members here today who are aligned with the Labor Party. However, the circumstances by which this parliamentary committee was established—and I repeat, I say this with the greatest respect—were that it was brought to the Senate, I believe, by Senator Williams, although I may be wrong on that, and at that time it very much included the banks. Squarely lined up in the crosshairs were the banks. Unfortunately, the circumstances dictate that the biggest bank in Australia, our national icon of lending and financial institutions, was solely at the centre of allegations. It very quickly became a joint parliamentary committee and the banks were not part of that inquiry—certainly not to the same extent as they again are today, thanks to the Senate again assuming power and insisting that the banks be incorporated.

I am hesitant to bring it up, but I am extraordinarily interested to find out why the banks were afforded that exclusion. I am not asking the committee to comment on it today. It is merely an observation that at some level it would appear the banks have been excluded—whether it be legitimately, as a consideration of the economic climate we find ourselves in, that the greater good be served that our banks not be brought into question; whether it be because of an inappropriate alliance between the heads of our four pillars and politics; or whether it be for some other reason. I urge you to go back and read the report of the Fitzgerald inquiry and try and apply it to the financial sector. It is very, very easy to do.

I am not a friend of the Cassimatis' and I will never be a friend of the Cassimatis'. From the moment I started through this process with my financial planner, one of the significant hurdles that my financial planner had to get me across was my dislike of the Cassimatis'. I make that point very clearly because you are going to hear from me today as a person who has examined the facts as they apply to my case and to many, many other people who have rung me and

expressed the details of their situations. You will be fully aware, as you have heard them repeatedly for the last few days.

Unlike some of my colleagues who appeared early this morning from the financial planning industry, I do not get my information from newspapers. I am a Queensland police officer who attends major crime scenes on a regular basis and I know that newspapers are not accurate. As a result, the information that I will pass to you today I pass to you as honestly and as succinctly as I can. You will note from two of my four submissions that you have received so far that you have a treat coming on 7 September. I have oath acted each and every one of my submissions that they are true and correct. I give evidence in court regularly. If I am found to be untruthful not only have I lost my investments through this debacle but I will lose my career. I have not and will not lie to this committee. I will not attempt to deceive you in any way.

That being said, the second thing that I would ask you to do is to have a second look at the Commonwealth bank's submission and note what I believe may be Mr Norris's signature that appears at the end of the index. He must be extraordinarily proud that the index is truthful and accurate of what is about to follow. He does not sign the end of that document. No-one from the bank has signed the end of that document. In legal terms no-one can be held accountable for the excrement which is smeared liberally throughout the document. I apologise for the crassness of the comment, but I have spoken to suicidal people for eight months; I have nursed my wife through a suicidal episode for two months. I have contractual agreements with my bank, who determined that it is fine for them to apply their own interpretations, adding whatever words they need necessary to make the interpretations fit, and then ending the conversations with, 'If you don't like it, sue us.' This is to a person who for 18 years has been a cash cow for the banks.

I have been described as one of the Storm people, as a greedy investor. I copped it again today. I will set the market straight: my sole goal was to ensure that my wife and I did not have to struggle on a pension provided by the government in our old age. The reason that is such a strong tune with me is that I watched my mother do it. I watched a woman who was unable to get medical insurance because of her illnesses have to go through the public hospital system. We are a lucky country but we need to take responsibility, each and every one of us, for our futures. That is what the Storm clients were doing. Make no mistake about it; they were taking responsibility for their financial future. Something has gone cataclysmically wrong, and I do not envy your position because now it is up to you to try and identify what has gone wrong and recommend politically palatable solutions that may prevent this having to be addressed again. The importance of that is that every single person from now on, whoever holds a job, is going to get a superannuation cheque. They may have to go to a bank and get advice about what to do with that. It might be 60 years down the track or it might be 15. Thank you, Mr Ripoll.

CHAIRMAN—I need to inform you that you have made a number of statements which I consider inaccurate. I would consider them to be not correct. They do not reflect the conditions of this inquiry, nor the circumstances of this committee. You are entitled to your views, but they do not necessarily reflect fact. I just need to inform you of that. You have obviously had a bad experience, as have a lot of people, with your involvement with Storm. I am not sure what more I can ask you. You made a lengthy and detailed submission and we appreciate that. It is good information and good evidence for the committee, and we will be working very hard to use your evidence, your circumstances and your submission to try and deal with the terms of reference and what we have been chartered to do: (a) to try and find what actually did take place, (b) to

have a record of fact concerning things that took place rather than just a range of views and (c) to make recommendations that we believe will go some measure towards having a better system.

Mr ROBERT—You indicated in your statement that your margin loan went from \$2½ million to \$3 million without your concurrence. Is that correct?

Mr McArdle—Yes.

Mr ROBERT—How did that happen?

Mr McArdle—I do not know.

Mr ROBERT—Did you give Storm Financial any authority to borrow on your behalf?

Mr McArdle—No.

Mr ROBERT—So there is nothing in the Ts and Cs that you are aware of? You are a forensic policeman, so you are used to reading Ts and Cs.

Mr McArdle—No.

Mr ROBERT—Then the only way would be that they made a loan on your behalf without your concurrence, which may be fraudulent—

Mr McArdle—Yes.

Mr ROBERT—if there is no way that you approved it or signed it, there is nothing in the Ts and Cs that gave them the authority and there is nothing written down that they can present showing they have authority to make a loan on your behalf.

Mr McArdle—If I may remind the committee, this was only less than a year ago. I am very, very clear that no authority was given to Storm Financial and no authority was given to the Commonwealth Bank or any of its subsidiaries.

Senator WILLIAMS—You say you are very clear on that, Mr McArdle. In your profession, have you kept diary notes, documents and every piece of correspondence right throughout your whole Storm investment?

Mr McArdle—Pretty well, yes.

Mr ROBERT—You indicated that when you were first contacted by CML on 8 December, Angus Cameron stated your securities had been seized and sold and you had a 126 per cent loan-value ratio. Prior to that, did they let you know that you had hit the LVR which you had nominated?

Mr McArdle—Prior to that day, I had had no contact with CML, Commonwealth Bank or CGI directly in any format.

Mr ROBERT—On the forms or documents you signed with Colonial Margin Lending or a lender before that, what did the Ts and Cs say with respect to whose responsibility it was for making a margin call and who would contact whom?

Mr McArdle—The Ts and Cs, which I have a copy of here if you would like them, are very clear in that there is an orthodox relationship between Colonial Margin Lending and you, the client.

Mr ROBERT—That is point 4.2, I think.

Mr McArdle—It goes right through and it is repeatedly stated throughout the document a number of times. Section 4.2 includes: ‘In the event of our providing you’. That is an example of the type of language that was used. It also mentions providing ‘you or your adviser’ with margin call advice in any number of ways.

Senator MASON—‘You’ being Sean McArdle?

Mr McArdle—If we go to the definition of ‘you’:

you or **Borrower** means the *person* who borrows money from *us*, whose details are set out in the *Application Form*. If there are more than one, **you** means each of them separately and every two or more of them jointly.

Mr ROBERT—Did Storm Financial contact you regarding the LVR when it was breached?

Mr McArdle—No.

Mr ROBERT—Why do you think CML breached its own guidelines in not informing you as per 4.2 of their Ts and Cs?

Mr McArdle—I believe it was a deliberate strategy.

Mr ROBERT—For what reason?

Mr McArdle—I was contacted by Angus Cameron on the 8th. He told me I had a margin call. I said, ‘Okay. How much money do you want to correct it?’ I mistakenly believed that this was my margin call. He told me that I was sold out approximately two weeks earlier and that it was too late.

Mr ROBERT—So you are saying that they did not, as per their Ts and Cs, contact you when you had breached the LVR and they actually called you on the 8th to say, ‘You’ve been in breach and, by the way, we’ve sold you up.’ That is outrageous.

Mr McArdle—It gets better! Again, at the risk of offending anybody, I suspect from what I have been reading and following that you people have been hearing over the last three days a heap of symptoms. They are symptoms, not a cause. We had a bank that was in negotiations with a financial planner on the 4th and the 5th. From the 6th, I have copies of scripts that were printed out—I have pages 28 to 34—which directly related to what CML staff were to tell Storm clients the following week when they rang them up, which was, ‘This is all Storm’s fault. It is nothing

to do with us. It is all Storm's fault and'—for the privileged few like me—'by the way, you owe us a substantial amount of money because not only did we not advise you of your margin call but we didn't sell you out and you are now in negative equity and you owe us money.'

Senator MASON—This was an orchestrated response; is that what you are saying?

Mr McArdle—These were scripts that were typed out for the staff to use to respond to clients. I would like to publicly thank Mr Angus Cameron from CommSec. He was recruited across and happened to get my number. He was a very patient, diligent and, I believe, too-honest-for-his-own-good person. He told me that there were 200 high-value—the bank's term, not mine—clients. If I am at the base of that list of people, we are talking low millionaires up to people with significant sums of money invested—\$15 million, \$18 million or \$20 million. None of those people were advised of their margin calls. Lots of those people have ended up in negative equity. The significant thing about negative equity is that it makes it very hard to walk into a solicitor's office because you would have to say, 'I've got a problem with my bank; would you like to do some pro bono work for me?' Why would the bank do that? I have never missed a repayment. In 18 years with the bank, I have never missed a repayment and never been late for a repayment. The only problem I had with the bank was once they cleaned out my account.

Senator MASON—I have a process question. Mr McArdle, did you nominate your LVR? What was your nominated LVR?

Mr McArdle—My LVR was nominated at 90 per cent.

Mr PEARCE—I just want to go to your submission, Mr McArdle. You say in the introduction of your submission:

Storm Financial have misled the McArdles into participating in an investment strategy by misrepresenting the exposure through the margin lending component of the product.

Can you share with the committee what that misrepresentation was.

Mr McArdle—I had a longstanding relationship with my adviser prior to Storm coming onto the market. He moved across to Storm and then he approached me. From the beginning of our relationship I had made it quite clear to him that, as a result of an experience when I was a 20-year-old lad at Mooloolaba, I did not like margin loans. I was not comfortable with them. I did not know anything about them. I did not want to have anything to do with them. We started working through the issues. Repeatedly, when I would raise questions over an eight-month period of due diligence, the biggest bone of contention was margin lending. During that whole time my adviser failed to mention to me that if you get a margin call and do not respond you are going to lose everything and be catastrophically left in debt. If he had, I may have been a little reluctant to sign up. That sounds like a smart-arse statement, I know, but the fact of the matter is that if my adviser had fully informed me, through accurate statements, of the potential for a margin call I would not have signed up.

CHAIRMAN—Mr McArdle, you are saying you were completely deceived by your adviser?

Mr McArdle—I am saying that by not telling me things—

CHAIRMAN—You were deceived by your adviser.

Mr McArdle—Yes, by not telling me things.

CHAIRMAN—Do you believe he knew he was deceiving you? Obviously, he did not tell you that you were getting a margin loan. I need to ask the question.

Mr McArdle—I know. I was not pulling that face at you. Like a lot of other people in this room, we had a relationship with our adviser. I would like to turn around and say, ‘No, I don’t think he did,’ but the bottom line is that he knew what we were getting into. He was a financial planner.

CHAIRMAN—He must have known.

Mr McArdle—If you look at the beginning of our first submission you will see that it has been revealed that my accountant was called into one of the meetings by me. I called my accountant in. I later found out that he received \$10,000 from my financial adviser.

CHAIRMAN—But he never disclosed that to you?

Mr McArdle—It was not mentioned at the time. He was there at my insistence to find out whether this was a suitable strategy. I had some concerns about the strategy, but they were put to rest over and over again.

Mr ROBERT—Did your accountant disclose that in writing?

Mr McArdle—No.

Mr PEARCE—I just want to go back to the submission. In your submission, under part 1, you talk about an experience—I am going to abbreviate it, if I can—where you applied for some margin loans through some branches of the bank.

Mr McArdle—Yes.

Mr PEARCE—You were given approval at a certain level. I think was \$350,000.

Mr McArdle—Yes.

Mr PEARCE—Then, if my memory is right, very soon afterwards you were told by somebody that you could actually have \$1 million.

Mr McArdle—Mr Pearce, I was so reluctant about the Storm product that I went around to multiple other financial advising firms and individuals, seeking their advice—not about Storm but about what they could offer me. I was going to leave my financial planner of seven or eight years. As part of that, I went to the Toombul branches and the Virginia branches, which are both branches in the northern suburbs of Brisbane. I gave them the same pay slips, the same tax returns and the same group certificates as I provided to Storm—not similar ones, not copies, but the same ones. I said, ‘What is the maximum amount you will lend me?’ To his credit, James

Lowe, the lending manager from Toombul branch, made the mistake of forwarding a formal application through to the bank. That came back saying, 'We will give Mr McArdle \$350,000 because, despite being asset rich, you are income poor,'—policeman's salary and all that. Very shortly after that, very shortly, I had in my hand clear-cut advice from my adviser that the Commonwealth Bank—the same bank—was going to give me a million bucks. I asked what the difference was—

Mr PEARCE—Did you apply for that, or was this mentioned one afternoon or something?

Mr McArdle—The loan?

Mr PEARCE—Did you actually apply through Storm for a margin loan?

Mr McArdle—Eventually I did make an application through Storm. But, prior to that, my adviser had said, 'We will get you a million.' I questioned that. I said, 'How come if I walk in off the street I can only get X amount; yet you guy can get nearly three times that amount for me?' The answer was very clear: the reason was that the relationship between Storm and the CBA was so strong. I have found the document that I was looking for. That will show James Lowe from the Turnbull branch doing the appropriate thing and coming up with a \$350,000 loan and on the back is the \$1 million loan from Storm—which was very shortly afterwards. If you would like to look at that document, it is readily available.

Senator McLUCAS—You have researched very well. You seem to be a very well-informed user of financial services. Why did you sign with Storm?

Mr McArdle—I kept going back to my adviser with my problems and saying, 'What about this?' and 'What about that? These figures don't add up,' and they would allay my concerns—and therein brings my solution as to how we can avoid at least the retail client and the financial adviser's problem. We talk about duty of care. Do not even consider that financial advisers are more reputable than Queensland police officers. Do exactly what Tony Fitzgerald suggested: if it is not independently corroborated, it did not happen; it was not said. It is a very simple process to record conversations and download them to a website that ASIC would monitor. It would be perfectly confidential and secure and would give ASIC the ability to save an enormous amount of travel costs if they were able to do remote auditing. It would also give us the ability to monitor ASIC's performance in relation to the auditing of their financial advisers.

CHAIRMAN—Mr McArdle, thank you very much. I do understand that people may get a bit confused about timing issues. We have cut out half the lunch and we have cut out breaks. We are trying to fit in as much as we can. We really do not want to cut people off, but we have another witness and we have flights that we have to catch and the committee has to travel to the next hearing. Mr McArdle, thank you very much. We have really appreciated your evidence.

[4.13 pm]

HANCOCK, Mr Benjamin William, Partner/Senior Adviser, Stonehouse Wealth Management

CHAIRMAN—Thank you for appearing, Mr Hancock. Would you like to make a short opening statement?

Mr Hancock—Yes, I would. I have actually prepared a statement, and I will try to keep it brief. Thank you very much for the invitation to appear before you this afternoon. I am appearing primarily in the capacity as an individual financial adviser but, as a partner in a financial planning group with its own AFS licence, it is difficult to completely remove myself from that capacity.

I think my submission adequately describes my view with regard to those terms of reference that I addressed but, prior to answering any questions that you may have, I just want to add some additional points in support of the proposed changes to the general regulatory environment and, specifically, the current licensing regime.

It is my strong opinion that licensees are the primary source of conflicts of interest in the industry, either by way of their direct links to financial product providers or through licensees' desires to become profit centres in their own right. In order to achieve this they seek to etch out a revenue stream derived from any source possible that allows them to minimise direct charges to their authorised representatives so as not to discourage new recruits nor dissatisfy their existing advisers, who would rightly begin to question the value they provide. The price of that reduced cost to advisers is in the form of an enormously truncated approved product list which limits the capacity of the advisers to provide, in good conscience, the highest quality advice to their clients—who ultimately suffer for it.

It is my opinion that licensees are a completely unnecessary component of the financial planning industry, and while their removal is no panacea, the government could abrogate many of the most firmly entrenched conflicts of interest from the industry by doing so. I have spoken to a number of financial advisers about the proposal to move from the current licensing regime to one where there is an individual financial advice licence and I have had unanimous support from all that I have spoken to both within our firm and through, in fact, a number of other licensees. I believe that the support for this change to licensing would be widespread amongst advisers who may be currently reluctant to vocalise it out of concern for the reaction of their licensee or because they may feel it would be a quixotic endeavour to pursue given the fierce level of resistance that would come from the banks and other institutional owners of what are, essentially, their product distribution networks.

Judging from my own previous experience as an authorised representative with a national licensee which is now 100 per cent institutionally owned, I think another reason that few advisers have thought of this option is that they have been indoctrinated by their licensees' scaremongering that they cannot survive without them, and this was certainly the case for myself and the other founding advisers of Stonehouse when we decided to establish our own licence four years ago.

By removing licensees and implementing an individually licensed regime, financial advisers who have previously been forced to comply with the conflicted requirements of their licensee overlords would become free to provide the highest quality, unhindered advice to their clients and would become solely responsible and accountable for the quality and appropriateness of their advice.

Finally, an additional benefit in placing advisers at the head and not the tail of financial planning firms is that they would be motivated by self-interest to become much more conscious of their corporate image. They would subsequently maintain higher ethical standards as they would recognise that a good reputation is much easier kept than recovered. Under this proposal, financial advisers would need to become responsible for their own professional standards, no longer being mollified by licensees whose existence is in opposition with their interests and the interests of their clients.

In summary, the benefits of removing the current licensing regime and supplanting it with an individually issued financial advice licence are: an increase in the professionalism of the advice industry; higher levels of control and accountability for advice by financial advisers; reduced potential for organisation-wide use of inappropriate financial advice models, as we have seen with Storm; removal of the most costly and entrenched conflicts of interest from the industry; and an improved public perception and greater confidence in the industry.

CHAIRMAN—Thank you, Mr Hancock. Have you been in the room most of the day and heard the evidence?

Mr Hancock—Sorry, but I have only just arrived.

CHAIRMAN—That is going to make it difficult to ask the next question. We have been given a lot to think about today and on previous days. We have had a lot of submissions and a lot of public hearings. We have heard some incredible stories and some tragic stories and of some incredible practices that took place in terms of what advisers were doing to their clients, what they were telling their clients and how they were treating their clients. We have also heard some incredible stories about the relationship between the advisers and the banks. Their relationship is perhaps known but the details of which are not known to clients themselves. What is at the core of the problem? How do we protect the consumer from unscrupulous advisers who do not act in the best interests of their clients? How do we do that?

Mr Hancock—I think the control and power of the licensee can be easily understated and the relationship between the adviser and the bank can really only be facilitated through an AFS licensee. I do not think that that would occur if that were not the case. As I mentioned, it is another case of the licensee groups being an unnecessary element, in my opinion—having to etch out a revenue source. Entering these arrangements with banks and being provided with brokerage which is not disclosed or perhaps not even passed on in any form to the adviser is entirely possible.

CHAIRMAN—In your experience, how easy is it to just comply with the law? We have the Corporations Act. We have laws. The law does try to give people structure and rules so that they do the right thing. There are always going to be people who do the wrong thing, but how easy is it for a company such as Storm or someone else to just simply tick the boxes as having complied

and to have the appearance of high-level compliance and yet still do the wrong thing by the clients? How easy is that?

Mr Hancock—Evidently it is quite easy. At the heart of the issue is the lack of a moral compass in the industry. I think the reason for that is a lack of accountability for the advisers individually. They have very little of a basis in the law. They are just simply representatives of someone else. Although it does flow through in some form to the adviser, they are not fully and solely accountable for the advice that they are giving. For that reason, they can be a little bit complacent when it comes to the advice. As I said, the controlling power of the licensee is very strong. If the licensee is condoning and in fact encouraging or maybe even forcing the use of certain strategies, as was the case with the recent collapse of Storm, it is not going to be addressed.

Senator MASON—I will be very brief but can I just congratulate you on your submission. It was short and to the point and it will assist the committee immensely in drafting our recommendations. There is just 1 point I want to take issue with. On page three of your submission you say that:

The requirement for appropriate and full disclosure is adequately entrenched in law and all advisers operating within the law are presently fulfilling this requirement.

But we have heard evidence over the last couple of weeks that, while there may in fact be disclosure, that disclosure is not transparent. Indeed, some witnesses have even said that disclosure has failed. So are you confident about that? Put it this way: we had evidence from Mr Cassimatis this morning that the statement of advice was 100 pages long. That is disclosure. We except that it is technically disclosure. But does it really disclose the risks and what people are getting into or can we do something about that to make it transparent?

Mr Hancock—Certainly there are very few circumstances in which I could imagine a 100-page document would be appropriate to provide to a client. I can only really speak of two licensees—the one that I am currently a member of and one that I was previously an authorised representative of. The disclosure requirements, in my opinion, were quite clear. I do not know if that is the same for all other licensees. I cannot speak to them. I do not often scrutinise the plans of other licensees, but I believe the requirement for disclosure is adequate enough.

Senator MASON—The letter of the law might be fine, but the committee is also worried about the spirit of the law.

Mr Hancock—I would like to see some examples of how this spirit of the law was circumvented while still complying with the letter of the law.

Senator MASON—A 100-page document might be.

Mr Hancock—Yes, but perhaps, for example, there might have been an index page that said, ‘fee disclosure, page 63’ and there it all is, laid out very clearly with fee disclosure. I am not sure whether the fact that there is a 100-page document necessarily means that they are not complying with the spirit of the law.

Senator MASON—I understand your point. You have not convinced me that it has been complied with in the spirit in many cases. The evidence we have received is contrary to that.

Mr Hancock—I just feel as though a document that is prepared with, for example, an index page that clearly identifies where in the document—whatever size it is—the fees are disclosed, provided that all the fees are disclosed on that particular page, that should be sufficient.

Senator MASON—It might be sufficient.

Mr Hancock—Might be.

Senator McLUCAS—Thank you, Mr Hancock, and I join others in thanking you for your submission. Your suggestion is replicated by a number of other financial planning organisations, in that there is a separation between the profession of advice and the selling of product—which I think is what you are saying.

Mr Hancock—Not quite. I personally believe that the recommending of a product is inextricably linked from the advice process—

Senator McLUCAS—Okay, I have misunderstood your submission.

Mr Hancock—I think that the issue is the fact that licensees are, I guess, controlling the advice process of the advisers beneath them, and that is what I take issue with.

Senator McLUCAS—I understand. I will leave it at that. Thank you.

Mr PEARCE—I am just a little bit confused, because on the one hand I think you are saying to us that you support change from the current system. Is that correct?

Mr Hancock—I do.

Mr PEARCE—Yet in your submission, Senator Mason touched on page 3 where you said:

The requirement for appropriate and full disclosure is adequately entrenched in law and all advisers operating within the law are presently fulfilling this requirement.

I think what you are saying is that everything is okay in that regard. Then on page 5, you say:

Any legislative change introduced in an attempt to force changes to commercial business practices, especially as it relates to fees and conflicts of interest will either be crude and cause the inevitable closure of many quality advice firms, or alternately, they will be completely ineffective and do little to enhance the standards ...

Again, you are saying that any changes would actually be negative to quality advice firms. I am a bit confused about that. Can you clear it up?

Mr Hancock—Certainly as it relates to fees, I think the point that I was trying to get across is that if advisers are forced to change—you would have read in the submission my thoughts on the fee structure—

Mr PEARCE—Yes.

Mr Hancock—I think that that was my primary thought as I was writing that was that commissions bundled within the fees of a product are, I am absolutely certain, in their last days, and I bid them good riddance. But the ability to charge an asset-based fee is very important to the way that our practices have been established, and in my opinion it allows us to provide the highest level of advice to our clients. I think that is really what I meant. As far as conflicts of interest are concerned, again I believe that the major issues there will be mitigated by the licensee regime change.

Mr PEARCE—Thank you.

CHAIRMAN—You mentioned the lack of accountability in terms of advice that is given. Because the process is relationship based—there is no question about that—how do you insert that integrity? How can the client know that, in that imbalance of power, what they are dealing with and what is happening is actually what is taking place after they walk out the door? How does that work in practice, in your experience?

Mr Hancock—The fact of the matter is that trust has to underline the relationship and it is largely a matter of trust. How do you ensure that financial advisers operate with due care and consideration of a client's needs and so on? I believe that that is something which is in part dealt with by their required membership of a reputable professional organisation—those sorts of things. As I said before, if advisers are at the head and not the tail of these organisations, they are very much more concerned about the reputation of their organisation, because they cannot be easily recovered. For that reason as well, to maximise even the sale value of their practices one day—

CHAIRMAN—Should we focus more on trying to ensure there are good products or should we focus more on ensuring there is good advice?

Mr Hancock—There are certainly a lot of good products in the market. There are also some that are perhaps not quite so good. I do not think that should be the focus. I think the advisers will demand the quality products and they know what they are looking for. The product providers are attuned enough to the needs of financial advisers and so it is not required so much at that level.

CHAIRMAN—There has been a lot of conjecture about who is responsible in the end in relation to margin calls. It seems nobody is too sure as to who is supposed to be doing what. Does there need to be more clarity about everyone's roles and responsibilities? It is all fine when the markets are going up and everyone is making money, but what happens when things go bad?

Mr Hancock—I do not often use margin loans for my clients. There are certain circumstances where I have. The only client of mine that has got a margin call is me. That is perhaps a difficult one and it needs to be clarified, no doubt. The issue can be that the financial adviser is an

intermediary between the margin lender and the client and there can be a disconnect in the communication process for whatever reason: the adviser is sick or away for another reason. So there needs to be a communication between the margin lender and the client to offset those potential circumstances, which probably occur too often.

CHAIRMAN—Can you clarify for the committee, in your view or experience, are there circumstances in which a lender will communicate firstly with the advisory firm then the client or always first with the client then the advisory firm—in terms of a margin call—or with both at the same time or one but not the other? What are the possible options and circumstances that can arise?

Mr Hancock—We deal with several margin lenders. I have found personally that Colonial were the worst at notifying the client and the adviser. Subsequently I have encouraged the other advisers in our firm to move their margin loans, to refinance them to another margin lender who I know provides much greater communication to the adviser. They will notify them via email as soon as—

CHAIRMAN—To the advisor?

Mr Hancock—Yes. As soon as the account goes into buffer they will notify the advisor via email, which then allows the advisor to pre-empt what may happen very shortly thereafter and gives them the ability to hopefully avoid a margin call. At the point of a margin call the margin lender will then contact the client directly if there has been no response from the advisor.

CHAIRMAN—You have just said that Colonial was probably one of the worst—that they did not call anybody and let it just keep going and going, and obviously going into negative equity. How is that possible? What would be the circumstances that could lead to that happening?

Mr Hancock—It would not, in the ordinary scheme of things.

CHAIRMAN—So what is not ordinary? What scheme of things could it—

Mr Hancock—Clearly, there was some sort of agreement between Storm as a licensee and the margin lender not to act on that. Maybe it was simply the bank's reluctance to do it, given the level of support that they had received from Storm. I am not quite sure. That would not occur for the majority of advisors. Their clients would not be given any, what the bank might consider to be, 'favours' initially. That just would not occur beyond the buffer that is a standard product feature.

CHAIRMAN—You do not see any other mechanism by which that would happen? We have also heard that these systems are normally automated, which means they do not really have an option. It just happens because of triggers. So for it not to happen meant that either the triggers were not there, that they were a lot higher than people were told or that somebody switched them off.

Mr Hancock—I will go back to my own experience with Colonial because I was actually away at the time and I did not receive the email to me as an advisor and as a borrower; and nor

did anyone else. They sold down Commonwealth Bank shares at \$27, and you can imagine how upset I am now. But that was the situation.

CHAIRMAN—Why was it the situation?

Mr Hancock—Well, because the account went into margin call territory and I did not keep an eye on it, because I was away at the time. In my case the bank acted at the appropriate level and closed out the position to ensure that the margin loan LVR was rectified and brought back into the black.

Mr ROBERT—In your case did the bank try and contact you?

Mr Hancock—They did not try to contact me by telephone, which I was most upset about.

Mr ROBERT—They tried by what means?

Mr Hancock—By email.

Mr ROBERT—Were they within their Ts and Cs?

Mr Hancock—I did not scrutinise them following the event. I just spoke to the state manager, voiced my disapproval and told him he would never get another loan from us.

Mr ROBERT—Granted, but you are an advisor. You are a professional. You are a chartered accountant and you advise people. Is that appropriate for a bank to say that their Ts and Cs is just email, not picking up a phone?

Mr Hancock—I do not think it is appropriate.

Mr ROBERT—Are they within the law? Are they within their Ts and Cs?

Mr Hancock—Well, I think that they probably are. But I was dumbfounded by the situation and immediately got on the phone to several other margin lenders to find out exactly what their terms and conditions were, to ensure that that would not be the case for any of my clients at any point.

Mr ROBERT—In their Ts and Cs is the phrase, ‘We will contact you,’ a definable term?

Mr Hancock—No, I do not think it is, actually.

Mr ROBERT—I think ‘you’ is a definable term. They define what ‘you’ means.

Mr Hancock—Yes.

Mr ROBERT—Do they define what ‘contact’ means?

Mr Hancock—No, I do not think they do. So it was just a matter of speaking to them and inquiring about what their policies actually are. But I do not think it is defined in their terms and conditions because I doubt very much that they would like to be locked in to having to phone someone in an urgent situation; although they possibly should be.

CHAIRMAN—Thanks, Mr Hancock. We really appreciate your submission and your evidence today. I thank everybody that has been here all day and in the gallery. We really do appreciate you being here. We do understand a bit just how difficult it is for you to sit through and have to listen again to all these things. We really thank you for your presence and your participation.

Committee adjourned at 4.39 pm