



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL  
SERVICES

**Reference: Financial products and services in Australia**

WEDNESDAY, 28 OCTOBER 2009

CANBERRA

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

**Wednesday, 28 October 2009**

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

**Members in attendance:** Senators Boyce, Farrell, McLucas, Mason and Williams and Ms Owens, Mr Pearce, Mr Robert and Mr Ripoll

**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**

<b>COHEN, Mr David Antony Keith, Group General Counsel, Commonwealth Bank of Australia .....</b>	<b>24</b>
<b>COMYN, Mr Matthew Peter, Executive General Manager, Equities and Margin Lending, Commonwealth Bank of Australia .....</b>	<b>24</b>
<b>FRENCH, Dr Brendan James, General Manager, Customer Relations, Commonwealth Bank of Australia.....</b>	<b>24</b>
<b>NAREV, Mr Ian, Group Executive Manager, Business and Private Banking, Commonwealth Bank of Australia .....</b>	<b>24</b>
<b>NORRIS, Mr Ralph James, Chief Executive Officer, Commonwealth Bank of Australia .....</b>	<b>24</b>
<b>SHEPPARD, Mr Wallace Richard, Managing Director and Chief Executive Officer, Macquarie Bank Limited.....</b>	<b>2</b>
<b>van der WESTHUYZEN, Mr Peter, Executive Director, Division Head, Macquarie Investment Lending, Macquarie Bank Limited .....</b>	<b>2</b>



**Committee met at 5.00 pm**

**CHAIRMAN (Mr Ripoll)**—I declare open this public hearing of the Joint Committee on Corporations and Financial Services, the ninth and final public hearing the committee will hold to inform its inquiry into financial products and services. The committee is inquiring into issues associated with recent financial products and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses. 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 or misleading evidence to a committee. The committee prefers to hear evidence in public but we may agree to take evidence confidentially. The committee may still publish confidential evidence at a later date, but we would consult with the witnesses concerned before doing this.

[5.01 pm]

**SHEPPARD, Mr Wallace Richard, Managing Director and Chief Executive Officer, Macquarie Bank Limited**

**van der WESTHUYZEN, Mr Peter, Executive Director, Division Head, Macquarie Investment Lending, Macquarie Bank Limited**

**CHAIRMAN**—I welcome witnesses from Macquarie Bank. I will give you an opportunity to make some opening remarks. If you could keep your remarks to less than five minutes we will then ask you some questions.

**Mr Sheppard**—By way of background, Macquarie Bank entered the margin loans business in 1998. We offered our margin loans mostly through independent dealer groups but in January 2009 we sold the majority of our margin lending portfolio and entered into a distribution agreement under which we now distribute margin loans originated by other parties to our clients. Today I will largely confine my opening remarks to Macquarie's association with Storm Financial, but we would obviously be happy to respond to questions on the committee's broader terms of reference.

In relation to Storm, it is obvious that many clients advised by Storm appear to have experienced severe financial stress during the global financial crisis. They were not alone in suffering losses, but clients advised by Storm appear to have been particularly affected. Macquarie was a provider of marginal lending products to clients of Storm Financial, and we also provided Storm Financial with a \$10 million corporate debt facility. That was made available in November 2006. Storm later requested to repay that facility in full, and that loan was discharged at the end of October 2008. At the end of October 2008, Macquarie had approximately 1,050 margin lending clients who were advised by Storm out of a total book of around 22,000 margin loan clients. So we had about 1,000 Storm clients in the context of 22,000 total clients.

As the committee is aware, margin lending is a financial product. It is used by many investors but it is not without risk. Our practice was to bring these risks to the clients' attention as part of the disclosure information attached to the margin loan application form. The information I am talking about included a recommendation that clients seek independent financial advice and an outline of the risks involved, including margin calls and the potential for losses. It also included suggestions on how clients could manage their risk. All margin loan applications included a signed acknowledgement that the client had read this information and accepted the risks involved. Macquarie also provided information that allowed clients to monitor and manage their investment.

I will comment very briefly on some particular matters, such as loan to value ratios, or LVRs, business agreements, dispute resolution, the margin call process and stop losses. The maximum LVRs on margin loans were always based on factors such as liquidity, historical price volatility and the nature of the investment. Storm-branded managed funds each received a maximum LVR



of 80 per cent plus a standard buffer of up to five per cent. These maximum LVRs were consistent with those applied to other securities of a similar nature.

Macquarie Investment Lending did have some customised business terms with Storm Financial, as we did with other licensed dealer groups. The principal details of the arrangements with Storm were set out in our supplementary submission. Macquarie has an established dispute resolution process and we have been using that process to respond to complaints made by Storm-advised clients who had margin loan facilities with us. We have made some payments for certain account errors where delays in our processing of redemptions or account closures may have contributed to financial detriment, but overall we have not identified any recurring or systematic errors.

As we stated in our submission, our approach to margin calls was to notify the intermediary, so this was largely an intermediated business. We did this across our entire loan book. In addition, we provided both clients and the intermediaries, including Storm, with access to a secure Macquarie website which was updated daily with all relevant loan information including the current LVR and whether the loan was in margin call. So every client had the opportunity to access their own website with up-to-date daily information on their investments and their margin loans.

During October 2008, we became aware that there was a breakdown in margin loan call notifications with Storm. Storm was apparently not passing them on to their clients. We responded by immediately investigating the situation and by late October we had commenced direct notification of margin calls to clients. We continued to be in daily contact with Storm to notify them of client margin calls during this period, and daily updates on the website were maintained. The intermediated margin call process continued to operate satisfactorily during this period with other dealer groups that we were dealing with.

More broadly, there has been public discussion suggesting that margin calls operated or were designed to operate as a stop loss for the benefit of the borrower. Our product brochures, as I have mentioned, disclose margin calls as a risk for the client; they are not a stop loss. The risk we identified in our documents was that, if an investor did not act in response to a margin call, the lender might sell the investment, so we identified many other risks as well. As mentioned, the specific issue we faced with Storm clients was that in October 2008—which, of course, was a very disrupted period in financial markets—Storm appeared to stop passing on margin calls to their clients. We sought quickly to address this through direct client contact.

Without doubt, many people have been hurt by the market downturn that commenced last year, particularly Storm clients. As we have set out in our submission, Macquarie supports the inclusion of margin lending within the same framework as other financial services in the Corporations Act. This is reflected in the new legislation being debated in parliament this week.

**CHAIRMAN**—Thank you, Mr Sheppard. The Commonwealth Bank of Australia has stated that, where it believes it has done wrong, it will right those wrongs. It has put forward a compensation resolution scheme and has gone to some extent to deal with product and advice failure to both its clients and Storm's clients. When will Macquarie be taking similar action on behalf of its own Storm clients?

**Mr Sheppard**—As I set out in my opening comments, Macquarie does have an established dispute resolution process. We have been using that process to respond to all complaints made by Storm-advised clients who had margin facilities with us. Where we have identified that we have done something wrong or made errors or where, as a result of something that we have done, there have been delays that have contributed to some form of detriment to the client, we have made payments in relation to that situation. As I have also mentioned, we have not identified any recurring or systematic problems or errors with our procedures.

**CHAIRMAN**—Can you tell the committee how many people have made a complaint or sought some sort of compensation or redress in terms of their portfolio?

**Mr van der Westhuyzen**—From October last year until Monday, 97 Storm clients have lodged a complaint with Macquarie.

**CHAIRMAN**—How many?

**Mr van der Westhuyzen**—Ninety-seven.

**CHAIRMAN**—What are you doing in terms of the complaints of those 97 clients?

**Mr van der Westhuyzen**—We have reviewed the files of every client who has made a complaint to Macquarie. In 32 instances where we have made an operational error or something administrative has not gone according to plan, we have rectified that position.

**CHAIRMAN**—When you say you have rectified that position—to what?

**Mr van der Westhuyzen**—We have made sure that we have rectified it to the point where the client is not financially disadvantaged as a result of the administrative error that we made.

**CHAIRMAN**—What do you mean when you say there was an administrative error? I am not sure what that means.

**Mr van der Westhuyzen**—It could have been anything from the client asking us to redeem some of their managed funds and us being late, through receiving an account closure form from a client which we might have processed late, right through to the minutiae where we debited a client's account for an amount of money, which dishonoured, and they asked us to refund their \$50 dishonour fee, which we did. So there were a range of things.

**CHAIRMAN**—Would you say that was a high number of people? It seems to me that that is a lot of people in terms of your Storm clients, given that Macquarie have repeatedly said they had very few Storm clients. It seems a high number in relation to the comment that you had very few.

**Mr Sheppard**—I have mentioned that there were over a thousand Storm clients. There were over a thousand clients, and they are the numbers of complaints that we have been dealing with.

**CHAIRMAN**—It seems at odds, though, with your previous submission and other comments by Macquarie Bank that they had very few Storm customers. You are saying there were a

thousand, and I accept that. Are you now saying that about 10 per cent of those have made complaints?

**Mr van der Westhuyzen**—About 10 per cent have lodged complaints with us. As I said, we have finalised 32 of those. With the balance, in some instances we have written back to the clients saying that we do not think there has been an error made on our part and we have approximately 20 that are still to be resolved. I think it is important to note too that 39 of those clients supplied complaints to us on a template letter.

**CHAIRMAN**—Can you also tell me what the deal was that was struck between Macquarie Bank and Storm Financial over LVRs, loan-to-value ratios?

**Mr Sheppard**—We have summarised that in our supplementary submission. You say it was a deal, but it was our practice to have customised service arrangements across all of our dealer groups, so it was not an unusual practice. With regard to the actual terms of the deal, first of all they are set out in the supplementary submission, but I will ask Peter to outline the arrangements.

**Mr van der Westhuyzen**—In terms of the loan-to-value ratios, our loan-to-value ratio on the Storm branded indexed funds was 80 per cent. That was our standard LVR for all other securities of that type. We had 14 securities in total that did have an 80 per cent LVR. Eight of those were Storm. So there was not any change in the LVR in that respect. Likewise, we had a standard buffer of up to five per cent. That was our standard buffer that applied to all of our other margin lending clients. So there were not any special LVRs for Storm clients.

**CHAIRMAN**—You say in your submission too that there was no special arrangement, yet evidence we have heard and seen is that there were particular congratulations between senior people at Macquarie and Storm about the special arrangements that were in place. If it was just the standard 80 per cent plus the five per cent, which makes it 85 per cent, that does not leave a lot of room for error on anyone's part. Eighty-five per cent means you really have only 15 per cent left. Given that the market began to fall, and fall rapidly, you would expect that Macquarie, with all its resources and intellect, would expect that things would move very quickly from 85 to 90 to 95 and, as we actually saw, to above 95 per cent, and some people going into worse territory. What was Macquarie actually doing to deal specifically with that?

**Mr Sheppard**—I will ask Peter to deal with that, but let me make the comment that that is actually one of the risks of margin lending. Markets can move relatively quickly and they can move—

**CHAIRMAN**—It is the risk, everyone understands that. We all know how margin loans work, but isn't the risk the level at which you set the margin loan? If Macquarie does a deal and sets the margin loan at 100 per cent LVR, you have increased the risk enormously. If you set it at 50 per cent you have decreased the risk enormously. We all understand the risk.

**Mr Sheppard**—We are talking about two types of risk here. There is the risk that the lender takes in ensuring that they are adequately secured on the loan. Of course, the prime purpose of maximum LVRs and the margin call arrangements is to ensure that the lender is repaid in the

event of a market fall. There is either a margin call or various other ways that a borrower can rectify the situation. The other type of risk is—

**CHAIRMAN**—That is fine, but how does the borrower know when they are so close to the edge? When you say ‘maximum LVR’, really we are talking about maximum risk. When you say ‘close to maximum risk’, how do you make those decisions? Isn’t that—

**Mr Sheppard**—Let me come to that. The other type of risk is the risk that is being run by the borrower. As we have mentioned, our business is generally an intermediated business. One of the things that we have always done in the risk disclosures we have made to people when they undertake margin loans is to point out the risks of the business and to strongly recommend that they have the benefit of independent financial advice which is suitable to their circumstances. The risks that the borrower runs are going to depend very much on the borrower’s individual circumstances. There are a whole range of factors here, including their overall financial position, their income situation—

**CHAIRMAN**—Sure; I understand that. But isn’t the risk that, if no-one calls their loan in and it is allowed to run over, the risk builds to a critical point which is catastrophic? That is the point.

**Mr Sheppard**—The risk builds to a point where the lender is forced to make a margin call. That is why—

**CHAIRMAN**—Who notifies them of the margin call?

**Mr Sheppard**—The margin call, in practice, is made through the adviser.

**CHAIRMAN**—Even though you state in your submission that, when this failed, Macquarie took on that responsibility?

**Mr Sheppard**—Let me complete the picture for you. There are a number of degrees of protection here. First of all, borrowers have the benefit of independent financial advice. The second thing that we provided for a borrower was access to a website which was updated daily, where borrowers could monitor their position—and we strongly recommended that borrowers, in conjunction with their financial advisers, continually monitor their position. The margin call happens when the LVR goes over the threshold.

**CHAIRMAN**—That is the point; it did not happen. It went over the threshold. In fact, it went substantially over the threshold and there was no call.

**Mr Sheppard**—Let us then deal with the process by which margin calls are made.

**Mr van der Westhuyzen**—In the past we had always notified financial advisers of margin calls. That was really as a result of us being an intermediated business, as we have said. We applied that process very consistently across both the Storm portfolio and every other financial advisory group that we dealt with. From our experience that process had worked really well. It was not really until October 2008 that we saw—and I will be very specific here—that Storm’s behaviour started to deviate compared to the way that other financial advisers were dealing with their clients in relation to margin calls. That is where we started to investigate this further and at

the end of October, as we said in our submission, we made a decision to start to notify Storm clients directly of that margin call. At the same time we also continued to advise Storm of the details of all of their clients every day.

**Senator MASON**—So Macquarie made payments when your lack of action caused clients loss? Is that right?

**Mr Sheppard**—Sorry; can you repeat the question.

**Senator MASON**—Did you say in your opening statement that Macquarie made payments when your lack of action caused the clients to lose money? Is that right?

**Mr Sheppard**—Primarily, where we made administrative errors—

**Senator MASON**—Does that include a delay in making margin calls?

**Mr van der Westhuyzen**—No, it does not.

**Senator MASON**—It does not? Why not?

**Mr van der Westhuyzen**—For the clients where we have rectified the position it was purely for administrative errors that we have made. As I said before, the practice of notifying advisers of margin calls happened, and we always notified advisers of margin calls on day one. It was the process of communication between the adviser and the client that needed to deal with the position the client was in. We would never dictate to a client that they had to satisfy the margin calls by an exact day. There would be a period and the adviser would need to discuss the details with their client, and they would need to work out a solution from there.

**Senator MASON**—We have not got a lot of time, sadly; but, as the chairman has pointed out, customers signed up to an LVR at 80 per cent. Okay, there might be a buffer of five per cent—I think you mentioned, Chair. They were sold out at an average LVR of 96.7 per cent. As a result that, people lost a lot of money. Okay, they were sold out at 10 days rather than five. The bottom line is that the delay in action caused people to lose their homes and their livelihoods. Why aren't you assisting in relation to that?

**Mr van der Westhuyzen**—I would not agree—

**Senator MASON**—It is not your responsibility?

**Mr van der Westhuyzen**—I would not agree that all clients were sold out at 97 per cent.

**Senator MASON**—No. That is the average. That is the overall average. It is a hell of a long way from 80 per cent.

**Mr van der Westhuyzen**—I think we need to look at each circumstance. It does come back to the point again that we notified borrowers of their margin calls via their financial adviser. We also made information available to the borrower directly through our secure website, and

advisers had access to that information as well. That practice had worked really, really well. It was not until October that—

**Senator MASON**—I accept that. But it did not work well this time, and that was the problem. That is why people lost their homes and their livelihoods, sir. That is the problem. The question is: who is responsible for that? We are trying to determine at least to some degree why that is.

**Mr van der Westhuyzen**—I think it also comes back to the point that a margin call is not a stop loss mechanism. We can never guarantee—

**Senator MASON**—Is not a what?

**Mr van der Westhuyzen**—Is not a stop loss mechanism. We can never guarantee that we will sell out a portion of a portfolio at a particular LVR.

**Senator MASON**—The relationship is between you and the client, not between you and the agent. It is to protect both you and the client. It is to protect not just the client but you as well.

**Mr Sheppard**—That is absolutely correct.

**Senator MASON**—In that case, why weren't margin calls made immediately and promptly in relation to the correct LVR? And they were not.

**Mr van der Westhuyzen**—The point here is that the notification of the margin call was made immediately and it was made promptly.

**Senator MASON**—I cannot hear you. My hearing is not good.

**Mr van der Westhuyzen**—Okay. The key point here is that margin call notifications were made promptly and they were made on time. That process from that point of view—

**Senator MASON**—Hold on. But were they communicated to the client?

**Mr van der Westhuyzen**—No. As I said before, our practice was to communicate those margin calls to borrowers via their financial adviser. At the same time, they had information available to them directly through their secure website.

**Senator MASON**—But that obviously was not sufficient, was it?

**Mr van der Westhuyzen**—In what respect?

**Senator MASON**—Because people were sold out at an average of 96 per cent, and 80 per cent was the agreed LVR. So something was wrong just on the face of it.

**Mr Sheppard**—We should point out that there is no guarantee that a margin call will always operate at the maximum LVR. Markets move and markets were moving and the markets were moving quite rapidly. The major reason that people were losing money was that they were

geared into investments which moved down rapidly. The margin call process, as we have said, did occur. Secondly, the website to which we advised clients either directly or through their advisers to monitor was updated on a daily basis. When people were in margin call, a red flag appeared on their website so that people who accessed their website either directly or through their adviser were absolutely aware that they were in margin call.

**Mr ROBERT**—Mr Sheppard, just out of interest, in the Ts and Cs of the documents that people signed with you for margin loans, who did they say was responsible for the margin call and who did they say you would inform about the margin call?

**Mr van der Westhuyzen**—To answer your first question, who is responsible for calculating the margin call—

**Mr ROBERT**—No. If I were a client of yours taking out a margin loan, I would sign your Ts and Cs. They would be a standard set. They would say who was responsible. If I am in a margin call situation, who is going to tell me? You or my adviser? What do your Ts and Cs say?

**Mr van der Westhuyzen**—The Ts and Cs say that we will seek to contact you or your nominated representative.

**Mr ROBERT**—Say that again, sir.

**Mr van der Westhuyzen**—Our Ts and Cs say that we will seek to contact you or your nominated representative.

**Mr ROBERT**—Are those the exact words?

**Mr van der Westhuyzen**—They are not the exact words but that is the general thrust of the statement.

**Mr ROBERT**—Could you provide a copy of the exact words?

**Mr van der Westhuyzen**—Sure.

**Mr ROBERT**—We need to be a little clear about the agreement that the client has with you as to who you are going to communicate with. Our problem is that no-one communicated with the clients—no-one.

**Mr van der Westhuyzen**—I think it also comes back to what we did in practice. We had for a number of years provided notification to clients via financial advisers. That practice worked well for a number of years across our portfolios. We strongly believe that it was actually quite a positive thing to provide details to the client's financial adviser because they were able to talk about specific details in relation to their client's personal circumstance and they were then able to make recommendations. I can also go one step further: there would be situations where we would call a client directly and give them the details of the margin calls and they would tell us to call their adviser. I believe this committee has heard evidence to support that as well. That was very consistent with the process we had in place, as I say, for a number of years, and it had worked.

**Senator McLucas**—Mr Sheppard, you said that with every client you had a signed document that recognised the risk that the client was exposing themselves to if they used this facility. For all of your over 1,000 clients, were those documents signed?

**Mr Sheppard**—I believe so.

**Mr van der Westhuyzen**—We have not checked every client file but I know that in our credit approval process we had a very, very distinct check list. Unless we had a signed instruction or a signed document from a client then the loan would not be approved.

**Mr Sheppard**—We are not aware of any clients where that has not been the case.

**Senator McLucas**—I am not either; I just asked the question. Can you assist the committee in giving some understanding of what you think the knowledge of those clients was about what they had signed? We have had many people come before us talking about how they had spoken to their adviser, Storm Financial, in terms that they were low-risk clients and then they have taken out what, in my view, is a very high-risk product. Can you give me an understanding from the dealings that you have had with these over 1,000 people of their knowledge of what that document meant?

**Mr Sheppard**—We had very few dealings directly with the people concerned. Our model, as we have mentioned, was to distribute margin loans through financial advisers. We agree with you that there are risks involved in margin lending, and that is why we strongly recommended that any of our clients who undertook a margin loan went through their particular situation with a financial adviser and went through the risks with their financial adviser. One of the things that we asked people to indicate to us when they took out a margin loan was that they acknowledged that we had recommended that they go through their situation with a financial adviser and that they did understand the risks.

**Senator McLucas**—It is my view—and you may not have a comment on this—that many of those people had no idea of the level of risk that they were exposing themselves to.

**Mr Sheppard**—That may be the case, but that is precisely why we strongly advised people to have the benefit of an independent financial adviser. Of course, people then made their own decisions as to the choice of a financial adviser. If you believe they got the wrong advice then that is a different issue.

**Senator McLucas**—You said that, when it appeared that the information about the margin call was not being passed on, you instigated your own contact with people and advised them of the personal website. Did you monitor the use of that website at all in the period after October 2008?

**Mr van der Westhuyzen**—No. We do not specifically monitor the use of the website.

**Senator McLUCAS**—But coming back to your point: when you called them, they by and large said, ‘Ring up my adviser; I don’t want to talk to you.’

**Mr van der Westhuyzen**—Yes.



**Senator McLUCAS**—Do you think you put in place enough information and enough support for those people in those very trying circumstances? We have had people who have sat in those chairs and told us that their level of financial literacy is not high. You know that Storm is not passing on that information. You put up a website but you did not monitor it.

**Mr Sheppard**—In relation to the determination by people of the financial decisions they made, our model, as I have said, was to act through intermediaries. We were not in a position—and indeed, we were not licensed—to provide financial advice to these people. That is why we advised in the strongest possible terms that people access a financial adviser. The website was to make available information either directly to them or through their adviser to monitor the position between the client and the adviser. That, as we have said, operated perfectly satisfactorily with the vast bulk of financial advisers through which we dealt.

It did not appear to operate well with Storm. It operated well with Storm for many years, and we have described to you the process whereby, as financial markets were deteriorating in early October, we became aware—I think it was around mid-October—that the margin calls were not being passed on to the clients. We immediately took steps to investigate that and as soon as practicable straight thereafter, late October, commenced direct notification to the clients. Prior to that, we were acting on the assumption—and indeed the evidence—that margin calls via Storm, as had been the case with every other adviser, had operated satisfactorily.

**Senator MASON**—Over the last few months we have received from people throughout the country evidence that they did not receive margin calls. I am not saying that you are responsible or that the Commonwealth Bank is responsible, but the bottom line is that the system did not work to inform people—that is the problem. The committee is now at the stage of its last hearing. The bottom line is that the system did not work to inform people that margin calls were being made. That is the bottom line. You say you had a process in place. But it did not work, because people did not get that information.

**Mr Sheppard**—We have told you that for a brief period during October that was the case, and as soon as we became aware of that we rectified it. We have also told you that—

**Senator MASON**—Every day it was delayed—five days is the usual time line, extended to 10, as the chairman reminded me—the market was falling. The market was falling so quickly that this in effect changed the LVR from 80 per cent to about 96.5 per cent. That is 15 per cent; it is a huge difference. The system did not work.

**Mr van der Westhuyzen**—One of the important things to highlight here is that we relied on clients to monitor and manage their portfolios, and we did say in our documentation that it is really important, particularly in times of volatility, to monitor your portfolio.

**Senator MASON**—Stephen Halsall, a former staffer of Storm, said this in his correspondence:

Our agreements and ongoing communication, hour to hour, with Macquarie Margin Lending has ensured that either no margin calls are being actioned or we have significant control over the relationship [so] that MML is taking directions from us.

Did you think your close relationship with Storm somehow upset your objectivity and prudent banking? Would you accept that, Mr Sheppard, or not?

**Mr Sheppard**—Not at all.

**Senator MASON**—So you do not think your relationship was too close?

**Mr Sheppard**—Not at all. It was an arms-length relationship. In fact, the primary relationship, of course, is between the client and the financial adviser.

**Senator MASON**—Not for margin lending, surely?

**Mr Sheppard**—What I have said is that the advisory relationship and the responsibility for monitoring the client's financial position is primarily a matter between them and their financial adviser. I certainly reject any comment that we were in any sense at all taking instructions from Storm.

**Senator MASON**—You were not seduced by them, sir?

**Mr Sheppard**—No.

**Senator MASON**—We had evidence from a former staffer, David McCulloch, that you said that part of the agreement was to lift the maximum LVR to 85 per cent for Storm clients with margin loans from Macquarie. That was his evidence. Were all clients notified of changes to their LVR?

**Mr van der Westhuyzen**—The maximum LVR on the Storm branded index funds was 80 per cent. I have read some comments about the LVR increasing to 85 per cent. That is not correct.

**Senator MASON**—Okay, that is fine.

**Mr van der Westhuyzen**—There were particular things that Storm did ask us, over a number of years, to consider. One of them was to increase the LVR on the Storm branded managed funds. We said 'no'. They also asked us to increase our buffer from the standard five per cent to a higher level and we said 'no'.

**Senator MASON**—Why did MIL and Storm agree to extend their response time to margin calls in a period when time is of the essence—in other words, from five days to 10 days?

**Mr van der Westhuyzen**—As I said, there were some times when Storm did request us to consider various things that they were looking for. We did agree in December 2004 to increase the satisfaction time period for their margin calls up to 10 days. That was something we agreed to in December 2004.

**Senator MASON**—Would you do that again?

**Mr van der Westhuyzen**—I think you need to look at the reason we did it. One of the reasons we increased the satisfaction period was the type of investments that Storm was recommending:

index-tracking diversified managed funds. That criterion that we used to provide an 80 per cent LVR on a 10 per cent margin call was something that we were comfortable with. At the time we actually thought that that was increasing Macquarie's risk.

**Senator MASON**—The market was different. One last question: in September and October how many margin calls did MIL notify to Storm and their clients, and of those margin calls how many were satisfied within 10 days?

**Mr van der Westhuyzen**—I can tell you that over the September-October-November period we notified Storm of about 1,400 margin calls.

**Senator MASON**—You notified Storm. How many clients directly?

**Mr van der Westhuyzen**—From the end of October we started to notify Storm clients directly. From that point through to the end of November, to give you a comparative period, there were 359 notifications directly to Storm clients.

**Senator MASON**—And of those margin calls how many were satisfied within 10 days?

**Mr van der Westhuyzen**—I could not tell you off the top of my head here but we can take that on notice.

**Senator MASON**—The committee would like to know that. Can you find that out and let the committee know.

**Mr van der Westhuyzen**—Yes.

**Senator MASON**—Thank you very much.

**Mr PEARCE**—I want to go firstly to a particular issue. I think, Mr Sheppard, that you told us that you had margin loan clients in the order of 22,000. Is that right?

**Mr Sheppard**—Yes.

**Mr PEARCE**—Macquarie represented just over 1,000 of those.

**Mr Sheppard**—Storm.

**Mr PEARCE**—I am sorry; Storm. I think it was 1,050. Regarding the arrangement that you had with that entire customer base of 22,000 across multiple teams of advisers—I would not try to guess how many—was that arrangement consistent across all of them?

**Mr Sheppard**—It was generally consistent. Obviously there were different LVRs. Some people borrowed against shares—

**Mr PEARCE**—No, the process.

**Mr Sheppard**—Yes, the processes were consistent.

**Mr PEARCE**—So across all of those 22,000 the normal stock standard process was that you would advise the adviser about a margin call and they would advise the clients?

**Mr Sheppard**—Yes, with the exception of the very small number of clients who did not have an adviser and were operating independently.

**Mr PEARCE**—But, for the 22,000 who came through advisers, the standard process day in and out, week in and out and month in and out was that you would advise the adviser and they would advise their clients?

**Mr Sheppard**—That is correct, and it is a very rigorous process.

**Mr PEARCE**—The situation obviously happened with Storm. Did you have the same situation happen with any of the other clients in your base?

**Mr Sheppard**—No, we did not. The procedures worked satisfactorily with other clients.

**Mr PEARCE**—Every day, every week and every month?

**Mr van der Westhuyzen**—Remembering that at the time the markets were going through a very significant period of volatility and we were in very strong dialogue with a whole range of advisers. We would have instances, for example, where even if the standard margin call satisfaction period was three days an adviser would call us and say: ‘Look, I’ve got a particular situation here with my client. They have been travelling or there is some other reason and we would like to ask if you would extend and give us some additional flexibility for another day.’ So we would work with the financial advisory community around that.

**Mr PEARCE**—So that happened in the standard way every day?

**Mr van der Westhuyzen**—Yes.

**Mr PEARCE**—The only problem seemed to happen with the Storm set of clients—is that right?

**Mr van der Westhuyzen**—Yes, that is correct.

**Mr Sheppard**—The problems we have described were essentially Storm problems.

**Mr PEARCE**—That is quite interesting, isn’t it. Have you been able to ascertain as to what you believe caused that differential in the Storm base only?

**Mr Sheppard**—No, we have not, in a sense, done an audit of what happened within Storm. I believe there were probably a number of reasons. We had very disrupted markets. I suspect that there were heavy transaction flows. But I am speculating as to what happened within Storm at that time. We did, as we said, go to investigate, and, Peter, you might talk about what our investigations—

**Mr PEARCE**—But I guess the key point is: the 21,000 other clients were able to be managed.

**Mr Sheppard**—Yes, other financial advisory groups were very actively managing the situation in those circumstances at the time, as you might imagine, and the margin call process was working satisfactorily.

**Mr PEARCE**—In relation to your arrangement with Storm, what products and services did you offer?

**Mr Sheppard**—We offered margin loans and we offered cash management trusts which were effectively cash deposit facilities. It was essentially confined to that. There were a very small number of—I think it was actually four—clients who were clients of Storm that had mortgages with Macquarie, but those mortgages were originated not through Storm; they were originated through other means.

**Mr PEARCE**—So you did not originate mortgages through Storm?

**Mr Sheppard**—No, we did not.

**Mr PEARCE**—So you, primarily, were dealing in this margin lending and cash management?

**Mr Sheppard**—Correct.

**Mr PEARCE**—And mortgages: as you say, four clients but they did not come through Storm?

**Mr Sheppard**—Correct.

**Mr PEARCE**—I am also interested in the customer management process that you identified. Am I correct in thinking that every client went through a procedure where they were required to sign some application form that, as I think you mentioned earlier, outlined the risk factors?

**Mr Sheppard**—Let me describe to you what happened. We sent every customer a margin investment lending document. In that document we set out—and this is not in small print; this is with big headlines and so on—and talked about the risks that were involved. We said: ‘When borrowing to invest there are additional risks that you should consider. These risks include margin calls as a result of market volatility; increased exposure, which can potentially increase losses; interest rate risks et cetera.’ We then said: ‘We recommend that you seek appropriate financial advice to ensure you adopt a strategy that suits your specific circumstances and discuss the strategy with your financial adviser to address any potential margin calls.’ And then we gave clients some insights as to how they should manage risk. The points that we made were these: ‘Be conservative in the amount that you borrow, always borrow within your capacity so you can accommodate any interest-rate rises, check the lending ratios before implementing the plan, diversify your investments, reinvest dividends to reduce your loan as a proportion of your total portfolio, make interest payments regularly, ensure that you have stable cash flow to meet interest payment obligations, monitor your investments closely, and invest for the long term.’ Then, when people signed the statement, we asked them to acknowledge ‘that Macquarie

strongly recommends that you obtain independent legal advice,' and that 'We have considered the risks and costs involved in purchasing shares and marketable securities and we are prepared to accept the risks involved.'

So we feel that, while it was not our role—and, indeed, we were not licensed to—provide specific financial advice to these clients, we believed it was our role to generally set out the risks involved in these activities and to strongly recommend in the strongest possible terms that clients involved in these facilities got the advice specific to their circumstances.

**Mr PEARCE**—My time is running out, so I will just ask: did every client get one of those packs?

**Mr Sheppard**—Correct.

**Mr PEARCE**—And every client that may have had access to the internet also was offered the provision of a website?

**Mr Sheppard**—Every client had access to the website. For every client, when a margin loan was signed up, we would send the client a letter and a brochure as to how they could access the website, including a personal access number. I accept that many of these clients would not have done it, but—

**Mr PEARCE**—Sure. But those people who did were able to see what their LVR was every day, were they?

**Mr Sheppard**—Every day of the week.

**Mr PEARCE**—Thank you.

**Ms OWENS**—I am just going to try to take some of the hindsight out of it. Foresight, of course, is another matter, but not many people had it in October. You said you became aware that Storm was not passing on the margin calls. When and how—I am more interested in how—did you become aware of that?

**Mr van der Westhuyzen**—It was around the middle of October of 2008. We started to see that we were not getting some of the satisfaction instructions back from Storm. We heard directly from clients that they had not been told by Storm that they had actually been contacted to provide that margin call information. That was within about four or five days. After we started to understand that, we had three representatives in the Storm office. They were there for two days. Once they returned we made an assessment and one of the things we suggested to Storm, as a way that Macquarie could assist Storm, was for us to apply our resources to contact their clients directly. We put that process in place as of 29 October.

**Ms OWENS**—Prior to mid-October there would have been margin calls at various times before, in the years past—

**Mr van der Westhuyzen**—There were.

**Ms OWENS**—and you did not have that problem.

**Mr van der Westhuyzen**—There were, and it did not really matter how many margin calls had occurred. In January 2008 there were 20; they were satisfied. In July 2008, we had 332 that we notified Storm of. The process had worked. It was really not until October that we started to ring up.

**Ms OWENS**—So it was four to five days. Did you call the Storm people in or did they come in?

**Mr van der Westhuyzen**—No, we sent three of our representatives to Townsville.

**Ms OWENS**—Okay. How soon after that did the process change?

**Mr van der Westhuyzen**—That was 23 and 24 October 2008, and we changed the process on 29 October 2008.

**Ms OWENS**—So it could have been a two-week period between when you first started to notice that there might be a problem and when you realised that there was, and then maybe seven or eight days before the process changed.

**Mr van der Westhuyzen**—During that two-week period we were still gathering information to come to a view. It was not immediately obvious.

**Ms OWENS**—No. Again, I am not trying to apply hindsight to it.

**Mr van der Westhuyzen**—No.

**Ms OWENS**—I am just trying to get a sense of what period of time it was. You said on two occasions that something happened on time, and then someone asked to close an account and it did not happen on time and the margin call was done on time. We will just start with closing an account. What is ‘on time’?

**Mr van der Westhuyzen**—That is within an appropriate time. It depends whether the client is redeeming security, when we have to wait for proceeds to come back to settle the loan and then to close it. ‘On time’ is actually not specifically prescribed, but we will say to clients that generally within 48 hours of receiving an account closure request we will put that in place. It really does depend on whether the client is asking us to redeem security as part of that process as well.

**Ms OWENS**—During that extremely volatile time I imagine that it was not just Storm that was handling more work than usual but that you guys would have been handling more ‘stuff’ than usual. Do you regularly monitor what you would call ‘on time’? Do you have KPIs and do you flag when something is going wrong in your normal working process?

**Mr van der Westhuyzen**—We do measure a number of performance statistics across our business and we have service levels internally. We try to track that based on our service levels.

We do not capture everything, but it is part of our business practice to make sure that we try to do as many things on time as possible.

**Ms OWENS**—Again this is not a criticism; I am just trying to get a sense of what the time was like and whether it was just a Storm client who complained that their account was not closed on time or whether there was a greater administrative burden in the company at the time.

**Mr van der Westhuyzen**—Without a doubt there was a greater administrative burden. They were very difficult times for advisers, for clients and certainly for our staff as well. We had staff working seven days a week—some of them were starting at five in the morning and working through to midnight. But right throughout that time the thing that we were very pleased with was that the system did not break down. We were able to pull in additional staff from other parts of our group as well to cope with the workload. The business performed well.

**Ms OWENS**—After 29 October when you started contacting Storm clients directly, did that stop the problem? Were Storm clients still crashing and burning at the same rate or did that ease some of the issues?

**Mr van der Westhuyzen**—Certainly the number of new margin call notifications that we made in November, for example, compared to October were substantially lower—by almost a third. At that time, and this is part of what happened in the Storm portfolios as well, a lot of the clients moved from their equities based investment—the indexed managed funds—into cash. By definition, cash is a far less volatile asset. On the basis that quite a few clients moved their investment into cash the amount of administrative burden through the Storm client base did reduce.

**Ms OWENS**—We have seen a massive growth in margin loans over the last decade. We have also seen probably over the last 20 years a massive growth in the number of inexperienced investors who receive their large lump sums and do not have a lifetime of experience behind them. Were you aware that there were self-funded retirees whose entire life savings were at risk in these kinds of margin loans?

**Mr van der Westhuyzen**—I am really talking from a margin lender's perspective, because that is how we would look at things. A margin loan does not afford us the ability to see all the personal financial details of the client, so we would look at the margin loan as a single product. But we did recognise that it was part of the financial advice process that a licensed financial adviser would provide. It was very hard to understand the full context of what was happening to the client and their overall financial position.

**Ms OWENS**—To what extent do you think the processes for this complex investment came about because we had so many good years in a row? If we had had more volatile circumstances, would you have adjusted your process and your relationships?

**Mr Sheppard**—Every time the stock market booms we do see investors tend to take increased risk. We certainly saw a surge in margin lending in the good times leading up to 2007-2008. We all know that investors were taking increased risks. That included institutional investors and banks as well as individual investors. So there was a degree of that going on. That is why we continue to stress the importance throughout this process of people getting financial



advice appropriate to their circumstances. As Peter said, we do not have that visibility as a margin lender. What we can do—and what we did do—is just stress the risks and stress the importance of people getting their own financial advice.

**Mr ROBERT**—Mr Sheppard, I note from speaking to other colleagues in the investment world that you are entirely consistent with respect to providing advice through to financial advisers rather than clients. There is no question that your business model and the way you conduct business is entirely consistent, and that is how you conducted business with Storm and other adviser houses. I also note the 1,400 margin calls from September to October. Obviously there was a range of issues you then moved directly to the client, which is again commendable in that respect. I have just a few quick questions. For those 1,400 margin calls when you were both bashing your head against a wall with Storm, what was the average time they were taking to get back to you?

**Mr van der Westhuyzen**—That is probably fairly similar to the other question. I cannot tell you off the top of my head.

**Mr ROBERT**—I will not hold you to it; I am just getting an idea. You obviously then quickly moved directly to the clients in their best interests. So there was obviously something that concerned the hell out of you.

**Mr van der Westhuyzen**—It would be fair to say that in the majority of cases we were receiving instructions back within the 10-day period. We also, as part of our supplementary submission, said that there was a mechanism whereby if the loan-to-value ratio exceeded 90 per cent then we could induce the satisfaction period to 24 hours from that point. In the majority of cases, from memory, we were receiving instructions back—

**Mr ROBERT**—And you said, sir, that Storm had asked you to increase your LVR from 80 per cent to higher but you said no; is that correct?

**Mr van der Westhuyzen**—That is correct.

**Mr ROBERT**—In all this debacle, sir, I think that you alone come out with your head held reasonably high.

**Senator WILLIAMS**—If I went into a margin loan with you and I had \$200,000 cash, you would lend me \$800,000—a million dollars worth of shares—and that would be 80 per cent LVR, okay?

**Mr Sheppard**—No, we would not lend to you against a million dollars worth of shares. At an 80 per cent LVR, if you had had \$200,000, we would have lent you up to \$800,000 provided that your investment was actually a diversified investment. If it had been individual shares, it would have been a much lower ratio.

**Senator WILLIAMS**—No, I am a Storm plan. Did you have a close working relationship with Storm?

**Mr Sheppard**—We had an arms-length working relationship with Storm.

**Senator WILLIAMS**—I will just press that, because you did sponsor one of their menus or something here. This flyer has, ‘Proudly sponsored by Macquarie Margin Lending, your partners in building your lifestyle,’ so I just gathered from that that there was obviously a pretty close relationship.

**Mr Sheppard**—We do occasionally sponsor events for financial planners. In the case of Storm, it was not—

**Senator WILLIAMS**—Why did Macquarie staffers fly up to Townsville last October?

**Mr Sheppard**—I think we have answered—

**Mr van der Westhuyzen**—That was 23 and 24 October.

**Mr Sheppard**—That was the question we answered before. We sent three staff up to investigate the situation when we became aware that the margin calls were not operating satisfactorily.

**Senator WILLIAMS**—Do you know how many days they were there, roughly?

**Mr van der Westhuyzen**—Two.

**Senator WILLIAMS**—Two days. What was the purpose of the inquiry—just to go through the Storm books, the Storm clients, or did you do it at your bank?

**Mr van der Westhuyzen**—Sorry, what was the question? What was the purpose?

**Senator WILLIAMS**—The purpose there was obviously to go through the LVRs of those clients that had not been put in the margin call and had not been notified?

**Mr Sheppard**—No, the purpose was to investigate why the margin call process did not appear to be operating satisfactorily during that period in October.

**Senator WILLIAMS**—And what was the result of those inquiries?

**Mr Sheppard**—The result of those inquiries was that several days afterwards we immediately changed our processes and ensured that the clients were being contacted directly.

**Senator WILLIAMS**—What did you tell Emmanuel and Julie Cassimatis when you had done that? Did you say anything to the Cassimatises when you took that action?

**Mr van der Westhuyzen**—Yes, we did advise them. Also, as I said before, that was one of the suggestions that we put forward as a way to assist Storm, because we suspected that there was some operational difficulty in managing the number of margin calls. But we did advise them formally.

**Senator WILLIAMS**—Storm had a facility with you for \$10 million but not at that time; is that correct?

**Mr Sheppard**—The facility I think we entered into in about 2004. That was a facility provided from another area of the bank. We provide facilities to financial advisers and other types of firms. It was a \$10 million facility, and it was repaid at Storm's request in October 2008 under a—

**Senator BOYCE**—What date in October 2008?

**Senator WILLIAMS**—I think it was refinanced by the CBA, actually, but—

**Mr Sheppard**—It was 29 October, I believe.

**Mr van der Westhuyzen**—It was discharged on 29 October.

**Senator BOYCE**—Was that discussed by your staff when they were up in Townsville?

**Mr van der Westhuyzen**—No.

**Mr Sheppard**—No. I suppose it was a coincidence, but it was repaid, and Storm had requested the repayment of the loan prior to that, I think some time—

**Senator WILLIAMS**—What was the timing between the report from your flying squad, if I can call them that, from closing out the margin loans and closing out the corporate loan?

**Mr Sheppard**—It actually happened at about the same time, but that was a coincidence because Storm had requested some time earlier that they wished to repay the loan, and we put into place the procedures.

**Senator WILLIAMS**—Would I be correct in saying that you saw Storm as a real problem that you wanted to get out of as quick as you could?

**Mr Sheppard**—No, the loan was repaid at the request of Storm.

**Senator BOYCE**—I just have one question that you may have to take on notice. You mentioned earlier, Mr van der Westhuyzen, that there had been margin calls throughout 2008 on Storm client accounts. Could you just give us a list, month by month, of how many there were each month for 2008?

**Mr van der Westhuyzen**—I can either take that on notice or provide that information to the committee.

**Senator BOYCE**—I think that would be best on notice, thank you.

**Mr van der Westhuyzen**—I certainly do have the information here. It would be fair to say that, through the period of January 2008 to June, the numbers were fairly small, and then it started to elevate in July 2008.

**Senator BOYCE**—And the process of notifying Storm and only Storm worked right through that time?

**Mr van der Westhuyzen**—Right up until October 2008.

**Mr Sheppard**—Yes, it did. But, as you might imagine, the margin call volumes tended to explode after the Lehman collapse, which I think was late September.

**Senator WILLIAMS**—Just on the point of monitoring their LVRs at home—the Storm clients et cetera—do you know if all those Storm clients were computer literate and had computers?

**Mr Sheppard**—No, we do not, and we assume that many of them probably did not.

**Senator WILLIAMS**—In other words, many of them could not monitor their LVRs at home, if that was the case.

**Mr Sheppard**—Yes, and that is the point, I suppose, of strongly recommending to people that they work in conjunction with a financial adviser, because the financial adviser also had access to the website. In practice, with many of these people, we know they relied heavily on their financial adviser and the financial adviser would monitor the website and give them appropriate advice.

**Ms OWENS**—Further to Senator Boyce's request for that information, it would be more useful if we knew not only how the Storm clients' rate of margin calls grew but how that related to the overall change in the number of margin calls for your other clients.

**Mr van der Westhuyzen**—Across the time—

**Ms OWENS**—Yes. In other words, did it change at a different rate, or did it just reflect the standard change across the market?

**Mr van der Westhuyzen**—From memory, again, I do not believe it did change at a very different rate, but we can certainly provide that more formally.

**Ms OWENS**—It is whether it is different—whether there was something that flagged you or whether it was just part of the pattern.

**Mr van der Westhuyzen**—Sure.

**Ms OWENS**—Thanks.

**CHAIRMAN**—Thank you very much, Mr Sheppard and Mr van der Westhuyzen, for your appearance today.

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**Proceedings suspended from 6.00 pm to 6.30 pm**

**COHEN, Mr David Antony Keith, Group General Counsel, Commonwealth Bank of Australia**

**COMYN, Mr Matthew Peter, Executive General Manager, Equities and Margin Lending, Commonwealth Bank of Australia**

**FRENCH, Dr Brendan James, General Manager, Customer Relations, Commonwealth Bank of Australia**

**NAREV, Mr Ian, Group Executive Manager, Business and Private Banking, Commonwealth Bank of Australia**

**NORRIS, Mr Ralph James, Chief Executive Officer, Commonwealth Bank of Australia**

**CHAIRMAN**—I welcome to the table witnesses from the Commonwealth Bank of Australia. I remind witnesses that giving evidence to the committee is protected by parliamentary privilege. We will give you an opportunity to make some opening remarks, Mr Norris.

**Mr Norris**—Thanks, Mr Chairman. I am pleased to be here this evening to answer your questions. My executive team and I have followed your deliberations closely, not only because of our involvement with Storm Financial and its clients but also because we understand that, behind all the talk, many people's lives have been affected. The hearings of the committee have brought into the open some of the pain, and I say to you sincerely today that through our own discussions and our own customer assistance team on the ground in Townsville we also know and understand how difficult some customers' lives have become. To those of our customers who have been impacted by shortcomings on our part: I am sorry and apologise to them on behalf of the Commonwealth Bank. It is for that reason that, many months ago, I publicly acknowledged that where we had got it wrong we would put it right.

I would like to explain how we are putting things right and, as a consequence, the improving outlook for many people. I believe that as an organisation we must accept and address the areas for which we are responsible and ensure that the problems we identify do not recur. This is a clear priority across the Commonwealth Bank.

I would like to update you on the progress of the bank's resolution scheme. At this point, around 2,300 people have registered to participate in the scheme, which is a little over 80 per cent of all of the people who had relationships with the Commonwealth Bank. Approximately 100 offers of settlement are currently being considered by our clients, we have reached a resolution for 53 customers, and the independent panel is currently reviewing documents and will be providing evaluations and determinations soon. Another clear and important priority for the foreseeable future is to expedite as many offers and settlements as we can. We want to help as many customers as quickly as possible.

Since the collapse of Storm Financial, responsibility as an issue has been endlessly debated and it is clear there remains a degree of confusion. When I first became aware that the collapse of Storm Financial would impact thousands of people, some of whom are Commonwealth Bank

customers, I determined that we would identify our contribution to the problem, assist customers whose position was affected and take action to rectify problems and hold people accountable. In truth, a degree of responsibility rests on the shoulders of banks, individuals and the regulator to a greater or lesser degree, and primarily on Storm Financial, who provided the financial advice as a licensed adviser.

As I have mentioned, our priority is to address the areas for which we are responsible and ensure that the problems we are accountable for do not recur. Our primary areas of focus are helping those of our customers affected by our involvement with Storm Financial and ensuring that where processes and systems have failed we minimise the possibility that this will happen again. Some of the actions we have taken include strengthening our property valuation decision-making system, notifying margin calls directly to our customers rather than through their financial adviser, and improving our lending procedures and processes and supervision of front-line staff. When we complete our reviews it is likely that additional initiatives and actions will be added to that list.

Internally, we have imposed a range of sanctions, including dismissal of those whose conduct fell below our required standard. This accountability reaches across all levels of the bank. I am pleased with the way our team has responded to customers and to the changes to our processes. We have implemented what I believe can be rightly described as an unprecedented resolution process, a process that is genuinely independent, fair and transparent. It is a process that addresses individual cases. It is putting it right where we got it wrong, and this has seen 2,300 customers, approximately 80 per cent of the CBA's Storm customers, signed up for participation. Importantly, it is a process that is working.

Finally, we are the only organisation to stand up and comprehensively acknowledged its responsibilities. We will continue to work to assist our affected customers. I welcome the opportunity to participate in discussions with the committee. Thank you.

**CHAIRMAN**—Thank you very much for your honest and wide-ranging remarks on the involvement of the Commonwealth Bank of Australia with Storm Financial. As a committee, we appreciate that. I know the compensation resolution scheme you have set up is a good process in dealing with these issues. I acknowledge your comments about the Commonwealth Bank of Australia also dealing with these matters and stating how you are working towards resolving some of these issues and righting any wrongs that have been made. I really appreciate those comments and I appreciate the time you have made to appear before the committee tonight.

I wanted to say that and to let you know that, on the basis of those comments and what the Commonwealth Bank is doing, my questions are framed in the sense of trying to better understand exactly what did take place. There are obviously some uncomfortable areas—the bank itself has said it obviously made some errors—but it really is about us as a committee trying to understand what took place so that we can look at the circumstances and find resolutions to some of those problems. As has been clear throughout this inquiry, we have been very interested in the relationship that existed between Storm and a number of its financiers and people who provided facilities to its clients. It is fair, and obvious, to say that there was a very close working relationship between a number of Commonwealth Bank officials and Storm, and I would say it was not just in the local region, but that it was a much deeper relationship that went to the state level and also, I would think, to the national level. That may be on differing levels,

but I am interested in your view on that relationship at your level—that is, senior executives within the bank—and at a state level.

**Mr Norris**—Mr Chairman, it may surprise you that I never met the Cassimatises. In fact I did not know of the bank's association or relationship with Storm until probably the latter part of 2008, and that probably would have been some time in late October. So the first communication I had with Storm was late November when a letter was sent to me by the principle of Storm, Mr Cassimatis, requesting an urgent meeting to discuss the situation that was rolling out in regard to the issues surrounding Storm's own situation—that is, the debt that it had to the Commonwealth Bank—and also looking to resolve situations in and around margin calls and whether or not we would be prepared to advance financing to Storm to assist its clients. So that was the first communication I had with the Cassimatises. The person who was responsible for that relationship effectively was our head of premium business services, Mr Grimshaw. Directly reporting to him was Mr Tait, who was heading our private bank at that time, which was responsible also for CGI, which was Colonial Geared Investments. I asked Mr Grimshaw and Mr Tait to meet with Mr Cassimatis and establish what his request was and that meeting subsequently took place in very early December. At that point it was decided there was little that the bank could do to assist the situation that had developed.

**CHAIRMAN**—Mr Norris, can you clarify whether you had initially agreed to meet with the Cassimatises at that particular meeting in Sydney and then had decided not to meet with them?

**Mr Norris**—No, at no point did I agree to meet with the Cassimatises.

**CHAIRMAN**—So you are saying that meeting was to resolve a number of issues including the outstanding debts of Storm Financial as a business as well as the margin lend issue in terms of margin calls?

**Mr Norris**—That was my understanding.

**CHAIRMAN**—In terms of the loan to value ratios and the agreement, there was an arrangement between Storm and the Commonwealth Bank. There was a particular point in time where there was an agreement and a letter, a change from a specific LVR to a higher LVR of 80 per cent and I think to an increased buffer area for those margin loans. You obviously are aware of that now, but were you aware of that at the time?

**Mr Norris**—I was not aware of that at the time.

**CHAIRMAN**—Is it common bank policy or practice that special arrangements or conditions are given to individual dealers, brokers, dealer groups or others in terms of increasing those margin loan LVRs?

**Mr Norris**—I think it is one of those situations where obviously there had been a relationship with Storm for at least 10 years in the mode of Storm, so that relationship had evolved over time. Certainly in that particular situation I was not really aware of the relationship until, as I said, pretty late in 2008. Obviously in any banking relationship there will be negotiations around certain terms and conditions that have a flexible nature about them.



**CHAIRMAN**—It is interesting you should say that the relationship had been there for 10 years. Should the length of the relationship have any bearing on the risk factors associated with any margin loan?

**Mr Norris**—I think one of the issues that you have in regard to dealing with organisations is that over time you see how that relationship plays out. My understanding is that until the problems occurred, with the significant disruptions that took place in equity markets in the latter part of 2008, the relationship with Storm had been a reliable one and there had been no cause to have any concerns. That is my understanding from looking at this through the lens of hindsight.

**CHAIRMAN**—I have read a lot of the evidence and submissions and seen a lot of documents about the relationship and why this relationship was so important and why Storm pursued, as did the bank agree to, special terms, special conditions. Obviously there is a benefit. The bank makes money out of lending money out of margin loans and other facilities. It appears to me that in particular there seemed to be a process where either Commonwealth Bank customers or Storm customers who had equity built up in their homes were identified either by Storm or by the Commonwealth Bank as potential new clients for, let us say, the Storm model. The link between those was converting that equity into a loan or then a further margin facility to invest through Storm into a Commonwealth Bank-CGI-Storm product so that it was almost a whole-of-product advice facility from the home equity, which the bank and Storm would have had knowledge of, to the refinancing through Colonial Geared Investments to their margin lending facility, through to Colonial Geared Investments in terms of the indexed funds which were Storm badged. Are you familiar with that process across your organisation?

**Mr Norris**—I think the issue here is that certainly the Commonwealth Bank was not identifying customers of the Commonwealth Bank to be customers of Storm. My understanding very clearly is that Storm initiated relationships on the back of financial advice that they gave to their customers. Some of those customers were directed or took out loans with the Commonwealth Bank on the housing side, and some of them took out loans with other banks. Likewise with regard to margin lending: margin lending was taken out with other providers as well.

My view is that this was not a tight relationship. From the organisation's perspective—from my perspective, from the board of the bank's perspective—we are talking about an organisation where the revenue from Storm itself was less than \$10 million per annum and, when we look at that in the context of around \$14 billion of revenue per annum, this was relatively, in relation to the overall bank operations, quite small.

**CHAIRMAN**—Numbers and statistics can do all sorts of funny things in terms of overall percentages of a large organisation like the Commonwealth Bank, but there is another statistic, and that is that the North Ward branch in Townsville was year after year the biggest lender and had won a number of awards and so forth. There are some anomalies about how it could even be possible that a regional branch could outstrip any other branch in the country. That aside, there is evidence to us that the people working for the Commonwealth Bank routinely identified, through the provision of spreadsheets, people who had high equity in their homes who were already clients but were potential clients for the Storm model—that is, to convert that equity into a loan and then, through Colonial margin lending, to a margin loan and, further, to Colonial Geared Investments through the Storm badged indexed funds.

**Mr Norris**—As far as the situation of the Commonwealth Bank identifying Commonwealth Bank customers to become Storm customers is concerned, I am certainly of the view that that was not the case, but I cannot speak unequivocally from the point of view of Storm customers who were also customers of the Commonwealth Bank who had loans with the Commonwealth Bank in regard to the practice that you have outlined. Maybe one of my colleagues here can.

**CHAIRMAN**—I would say to you that, in either case, maybe you should have a closer look at where that practice was taking place, where spreadsheets were provided to Storm.

**Mr Cohen**—I think I can add some comment there that might help. There were spreadsheets, as I think the committee has heard, that were exchanged between the bank's Townsville operation and Storm. They were spreadsheets that had on them lists of names of Storm clients. They were actually Storm clients already. This was not a process of the bank sourcing new customers for Storm. These were Storm clients.

**CHAIRMAN**—You misunderstood my question. These were not new customers. I said 'new to the model', the Storm model. They were already customers of some description but were now potential new Storm model clients—for the high leveraged margin lending. This was not a simple process of just identifying any old potential Commonwealth Bank of Australia customer. That database is too big. This was about those who were already clients of Storm but where the bank would identify them as potentially having available high home equity so they could use the full facilities of the Commonwealth—that is, the margin lending and then across to the geared investments as well. They were all tied in. It was all Storm badged. It was what I would refer to as a very cosy and close relationship.

**Mr Norris**—But they were Storm customers.

**CHAIRMAN**—Are you saying to me that you think that is appropriate—that the bank would identify to an outside party its own customers in terms of those that might be ripe for the picking—

**Mr Norris**—I do not think that occurred.

**Mr Cohen**—What I am trying to say is that that is not the way it actually operated. It was not a case of the bank providing lists of existing customers to be thrown into the Storm model. In fact, to the extent that there were spreadsheets exchanged, it was done on a home loan basis only. So it was in relation to home loans, not, as I think you are suggesting, a plan to take up home loans and then take up margin loans and then take up—

**CHAIRMAN**—No. You have missed it again. It was not to take up home loans. It was to convert the existing home loans into something else, where, through the identification of the home loan, you would know how much equity was in the home. This is where the valuation assessment system comes in of revaluing or valuing the home. Where the bank officials could identify a large equity stake, then that person could be a potential new model client, rather than a Storm client.

**Mr Comyn**—Maybe I will spend a minute to explain the process. Effectively, Storm was selecting customers who were Commonwealth Bank home loan customers. They would

approach the bank under the pretext of their customer wanting to take out additional borrowing against their home. They were not solicited or sourced by the bank. With these spreadsheets that we are referring to, we were told the customers were supplying their owner's equity—the value that they put on their own home—and VAS was used to decide whether a valuation was required to verify that valuation. The only spreadsheets that I have seen are spreadsheets that came in from Storm, where we used the VAS system to identify whether an external valuation was required. The results of those were then sent back to Storm.

**Mr Norris**—It was not initiated by the bank.

**Senator MASON**—I echo the Chairman's comments and welcome you gentlemen—Mr Norris, in particular. Thank you for coming, and for your forthright and frank evidence. Our questions are not meant to be impolite, they are meant to be searching. That is what parliamentary committees are all about.

**CHAIRMAN**—Hopefully, they are!

**Senator MASON**—Mr Cohen, when I asked you about the response time to margin calls pre-2003 at the public hearing in Sydney you agreed that a margin call had to be satisfied within five days. Is that correct?

**Mr Cohen**—Yes.

**Senator MASON**—Did this five-day response time change at any point?

**Mr Cohen**—Did we extend the period?

**Senator MASON**—Did the five-day response time for margin calls, as the standard reply time, change?

**Mr Cohen**—Not that I am aware of, no.

**Senator MASON**—Is that because with margin calls time is, in effect, of the essence?

**Mr Cohen**—It is important, yes. As you can understand, the margin call process is there to protect both the borrower and the lender, and therefore letting time drift, as you know, is generally not a good thing.

**Senator MASON**—I used that very line of yours from the Sydney hearing with our previous witnesses from Macquarie Bank, because you are dead right. How many margin calls were made in September and October to Storm clients via Storm? Do you know?

**Mr Cohen**—Yes, we have those numbers here. For the period from 1 October to 31 December—it is not the exact period that you have asked for, but these are the numbers that we have today—a total of just over 2,600 margin calls were made in respect of Storm clients to Storm.

**Senator MASON**—Via Storm Financial? I just want to get that right.

**Mr Cohen**—Yes.

**Senator MASON**—Particularly in the period September through to October—I do not know if you can answer this, but we have got 2,600 all up between the beginning of October and the end of December—how many were addressed within the five-day limit response time?

**Mr Cohen**—I do not have the answer to that, and I am not too sure if any of my colleagues do?

**Mr Comyn**—No.

**Mr Cohen**—Perhaps we can take that on notice?

**Senator MASON**—Do you see how critical that question is?

**Mr Cohen**—I can see the purpose.

**Senator MASON**—I am sure you can see why that is a critical question. I suspect, if it were 2,600 marginal calls, there must have been at least several hundred. Do you agree that is a fair assumption?

**Mr Cohen**—At least?

**Senator MASON**—Several hundred between September and the end of October?

**Mr Cohen**—Actually, we do know that as of the end of September there were approximately 40-odd—I cannot be more precise than that; it may be 45—margin calls outstanding.

**Senator MASON**—So you are aware even of that. Your first margin call was on 18 September and there were 45 outstanding by the end of September.

**Mr Cohen**—Yes.

**Senator MASON**—Perhaps this is what is bugging the committee: we just heard evidence from Macquarie Bank that their first margin calls were made in early October, and because of a lack of action by Storm they started contacting their clients directly from 29 October—I think that was the evidence. So it was about two weeks from their first margin calls; because they did not get any response, two weeks later they started contacting clients directly—that is what Macquarie did. Your first margin calls were on 18 September and there was no contact directly with clients until early December. You are not talking about the two weeks that Macquarie took; you are talking about 11 weeks, by which time people lost their homes, their houses and their livelihoods. Do you see?

**Mr Cohen**—I understand exactly what you are getting at, Senator. I think as we said at the first hearing, that would appear appalling if there was absolutely no action being taken. But, as we explained in our first appearance, there was action being taken.

**Senator MASON**—There was some. You just said that there were 45 even by the end of September.

**Mr Cohen**—Yes, 45 were at that stage outstanding. What happened during October, as I think we explained, was that we received more than \$700 million of action from Storm. That translated into \$600 million of actual redemptions due to changing market values.

**Senator MASON**—But what percentage in October were not being addressed within five days?

**Mr Cohen**—I do not have that information with me.

**Senator MASON**—They are critical questions. I just get the feeling that, given Macquarie's response compared to the CBA's response, it looks terrible. I will be very frank with you. It looks awful—an 11-week delay. Two weeks was enough for Macquarie, and the CBA it delayed it 11 weeks. Sure, there might have been some action in some places, but to not be alerted just strikes me—and I cannot speak for the committee on this—as inexplicable.

**Mr Cohen**—It is fair to say that we were alerted. There is no doubt that we were alerted. I would not like to give the impression that we were sitting dawdling.

**Senator MASON**—That makes it worse. You were alerted but you did not act directly.

**Mr Cohen**—We actually did what we thought we ought to do at the time—that is, allow those customers who had received margin calls to consult with their financial advisers as to what to do in response to the margin call. The role of the financial role is to give advice, once a margin call is received, as to what to do next. Customers do have several options.

**Senator MASON**—Mr Cohen, I accept that. Mr Sheppard from Macquarie just gave evidence. He gave us exactly the same thing: that it is best to act through an adviser and all that—and the committee accepts that. I am not saying that is incorrect. But we are not talking about two weeks any more; we are talking about 11 weeks. The Commonwealth Bank has never explained that length of time adequately—not to my satisfaction.

**Mr Comyn**—If I may, I would like to respond to your question. One of the reasons that I think it is hard to answer your question is that, generally when we talk about clearance of margin calls within a five-day period, that is generally the timeframe that the adviser will take action to clear that margin call. That does not always indicate that the funds are actually redeemed. As you would know, that process is quite manual and, during that period of time when funds are freezing, it can take two to three weeks for the actual funds to be received—in which case, the client may have triggered into margin call on subsequent occasions.

I think what was actually occurring during that period was that, whilst clients were in margin call, we were advising Storm that those clients were in margin call. We were receiving requests to redeem those funds. A very high compliance rate of clients that were in margin call were being cleared but during that period we were also seeing continuing equity market falls, particularly during October. So sometimes when we were seeing proceedings being received, the proceeds were actually less than they were at the time of the request being made.

**Senator MASON**—Mr Comyn, okay, okay, okay. There is a bit of this and a bit of that, but that is still not an adequate explanation for an 11-week delay. That is the problem. I accept that for two or three weeks you might say, ‘Yeah, okay’—maybe even if its four weeks, but not 11 weeks. It is five and half times what it took Macquarie Bank to start saying, ‘Gee, we’d better contact these people directly.’ I am not suggesting that you are all wrong. But, quite frankly, it is all just at the edged what you are saying. It has an impact but it does not justify a lack of direct contact, does it?

**Mr Comyn**—I cannot speak for Macquarie, but, as Mr Cohen said, when we are taking about \$700 million worth of funds that were being redeemed, that is more than 50 per cent of the total funds that were outstanding. I think the last of those redemption proceeds were received in about mid November. During that period, also in parallel, you have got other redemption requests occurring at the time—either at the request of Storm or originating from within CGI.

**Mr PEARCE**—Mr Narev, did you not tell us at the Sydney hearing that what you were doing was sending two files a day to Storm?

**Mr Narev**—We were sending three files a day of information from Storm and we also had indications from Storm that they had their own information. What I would add to what Mr Comyn has said—I think this is an important point of context—is that when a margin call is cleared it is not necessarily a customer selling the investment, getting out of it and stopping a loss. In many cases margin calls are cleared by customers posting extra security. If that is the case, a customer can, by having met a margin call, find themselves in a substantially worse situation than they had been in. If the situation were that the only way to clear a margin call was to say, ‘I’m out of the market and I’ll sell up; I’m gone,’ that would be one thing, but in fact the mindset of a lot of people on the margin calls, unfortunately, was, ‘I could meet a margin call by posting more security.’ At that point they are actually doubling down. Although, Senator, I understand your point regarding time being of the essence—I think we all agree with that—the difficult fact here is that it might actually have gone the other way.

**Senator MASON**—Sure; I accept that. But you were talking about 2,600 margin calls and no direct contact for 11 weeks. I am not saying that there are not points at the edges, and I accept that Mr Comyn has tried, but that is not good enough.

**Mr Narev**—I think the fundamental difference—although I cannot speak for Macquarie—is this: the decisions that a customer has to make when he or she receives a margin call are quite complicated. They provide a different range of things which a customer might do. We have said that for a long period of time we held the belief that the right way for the customer to have that discussion was with their financial adviser. Indeed, even when we started contacting customers directly in December, many customers were saying to us: ‘Why are you calling me? I want to speak to my adviser.’ As we went through that process we fundamentally believed—and our interests in Sydney, as I think I said, were aligned with those of the customer here; there is not a zero-sum game—

**Senator MASON**—I accept that.

**Mr Narev**—In fact, what we were—in hindsight, mistakenly—hoping would happen here is that a customer would have a discussion with his or her adviser about the margin call and make a prudent decision with a licensed financial adviser.

**Senator MASON**—Mr Narev, we heard that exact line of argument from Mr Sheppard. He echoed exactly what you have just said, except that it took Macquarie two weeks to act, not 11. That is the problem.

**Mr Norris**—I would just like to make the point that if there is an issue here then certainly—

**Senator MASON**—I think there is.

**Mr Norris**—the resolution scheme is going to resolve that. I think the point is that the Commonwealth Bank has faced up to its responsibilities and, where there are issues or problems, we are—

**Senator MASON**—I accept that. I understand that. I am not disputing that. My time is up; I am just getting started.

**Senator McLUCAS**—Mr Narev, we spoke in Sydney about the changed policy since 2003, when the policy of the bank, as I understand it from our discussion, was that the bank made direct contact with the clients. Mr Cassimatis's view was that that was the policy and that it stood. You indicated to me that at some time between 2002 or 2003 and 2008 there had been a change of policy and that you could not identify when that was. Have you been able to go back and—

**Mr Narev**—No, I am afraid not. I know this will not be a satisfying answer, but we cannot point to the exact time the policy was changed. What we can say is that to our knowledge it was significantly in advance of the events of 2008 and certainly not at all related to the events of 2008.

**Senator McLUCAS**—Can you help the committee by providing us with some advice about when that change of policy was communicated, and how, to Storm Financial?

**Mr Narev**—I cannot give you any details. I would have to take that question on notice. I have not been able in my inquiry to determine exactly when the policy was changed.

**Senator McLUCAS**—I take your point that it was some time between those dates but that it was not up close to the events of 2008. What I am keen to understand is how that was communicated to Storm Financial, because we have evidence that is contradictory to that.

**Mr Narev**—I accept that there is contradictory evidence. What I can say is that, based on my own review of discussions internally et cetera, I would be very surprised if, going into 2008, Storm could have been under the impression that Colonial Geared Investments' practice was to contact clients directly. Also, it would have been the only one of 7,000 dealers that we had that policy with. I think that, as you have heard from Macquarie, they had the same policy. I would find it very difficult to understand—although I cannot point to the date—that there was any misapprehension about that at the time we are talking about.

**Senator McLUCAS**—Okay.

**Mr Cohen**—There were occasions—not many, admittedly—prior to 2008 when Storm did respond to margin calls using this model, so I do not think there could have been any doubt on Storm's part given that they had responded in this fashion previously.

**Senator McLUCAS**—I want to go to some questions that relate to the Townsville hearing. We spoke with former Commonwealth Bank employees up there around the question of sales targets. Can you explain how local economic and demographic factors are taken into account when the bank sets sales targets to ensure that they are appropriate and responsible?

**Mr Norris**—As far as sales targets are concerned they are looked at with regard to the background economic outlook, and we have a very comprehensive economics department within the Commonwealth Bank which looks at the economic drivers in each of the different states and comes up with a growth potential for those particular states. Areas and targets are established as a result of that. If you look at the difference between the various states, over the last several years Queensland and Western Australia have performed at a higher level of growth than New South Wales for example, so that has an impact on targets. There were some changes made to targets based around the fact that with the global financial crisis there was a significant change in mortgage flows between financial institutions, so we saw a situation going into the global financial crisis in 2006-07 where targets would have been based around a flow of around 60 per cent of mortgage applications flowing through the major banks. With the global financial crisis we saw the flow increase some 50 per cent. From 60 per cent to 90 per cent of flow was going through the major banks, so that had a significant impact on the volume.

**Senator McLUCAS**—I am talking prior to the GFC and I am trying to get an understanding of why the sales targets for the Townsville region changed so significantly from 2006-07 to 2007-08.

**Mr Norris**—From what I have seen it has been a situation where those numbers were pretty consistent with what was going on in northern Queensland in particular, so I do not see that those numbers were significantly out of line with what we were seeing in the rest of the market. It is also important to realise that Storm Financial and the customers that had home loans with the Storm relationship made up less than 0.2 per cent of the bank's loan books, so relatively speaking when you look at overall targets the numbers were not huge or out of line when you looked at Queensland overall.

**Senator McLUCAS**—I am sure that it is not 0.2 per cent of the sales at the Aitkenvale branch.

**Mr Norris**—Aitkenvale was never a branch. Aitkenvale was a processing office, a regional office.

**Senator McLUCAS**—Sorry. Is it North Ward branch? That's BOQ, isn't it?

**Mr Norris**—That's BOQ. The other issue that came out of this was that these loans, while they may have been generated in Aitkenvale from the point of view of processing, were domiciled across Queensland in different branches. So from the point of view of identifying



them as Storm initiated loans it was difficult in that the loans were domiciled across a large number of branches in Queensland.

**Senator McLUCAS**—Explain that a bit more to me. Aitkenvale branch was a processing branch.

**Mr Norris**—Aitkenvale was not a branch. It was a regional office, and so the branches where those loans were domiciled would have been a Commonwealth Bank retail branch. I think one of the issues that has come out of the process is the fact that these loans were spread out across a large number of branches. From our perspective one of the difficulties we had earlier on in this process was identifying which home loans were linked directly to Storm.

**Senator McLUCAS**—We might have to go back and read *Hansard* on that; I am not quite following it, but that is okay.

**Mr Cohen**—The only thing I would add is that, as Mr Norris has said, Aitkenvale was a centre. There were several sources. I think you might have had the impression that it was just a single branch that everything came through. We did have, as we said in the previous hearing, a group of lenders who were just writing loans that had been referred from Storm, and they were based in the area, yes. But, as Mr Norris said, there were other sources.

**Senator McLUCAS**—Thanks for that. This is my final question. You would have seen that IFSA, FPA and ASIC have all talked about commissions as skewing the market. Is the bank contemplating looking at the use of sales targets in the same context? It has been put to us, particularly in the Townsville hearing, that it is the view of some that the increase in sales targets for the Townsville region, which are equivalent to those for Brisbane—and you can have a discussion about how equitable that is—was skewing the behaviour of CBA employees in that region and therefore the relationship with Storm was growing at a very high rate. Townsville is the home of Storm as well, but it has been put to us that the use of increased sales targets outside of what the usual demographic and economic analysis should be was changing the behaviour of the employees of your bank and that that was partially to blame in this story.

**Mr Norris**—From my perspective and that of any organisation, the tone for the organisation has to be set from the top. Certainly, from where I sit, there is no way I would condone a process of overselling. The selling process and the sales and service program that we have in the Commonwealth Bank is based around what is called a needs analysis process, which is identifying the needs of a customer and providing products that meet those needs. We use a program that is provided to us by a company called Cohen Brown, which works with 400-odd leading banks around the world. This program has been in place for probably around 15 to 20 years. We have used it very successfully in our New Zealand subsidiary. We have used it latterly and successfully here in Australia.

The two issues that, for me, make the success of any organisation are, one, the people who work in the organisation and, the other, the customers of the organisation. In order to have a successful business, you have to have customers who end up being engaged and who appreciate the organisation. To achieve that, you have to have a good level of people engagement. Over the last two to three years we have put in place a number of very structured processes that have

established a very good sales and service system. At the same time, we have worked very hard on improving the engagement of our people with the organisation.

I am pleased to say that we participate in a survey that is run by Gallup out of the United States that measures people's engagement with companies and covers millions of people and thousands of corporations around the world. Over the last three years we have moved from being outside world best practice in our engagement scores to being well inside world best practice. At the same time we have seen a significant improvement in customer satisfaction. In the *AFR* this morning there was an article indicating that the Commonwealth Bank over the last 12 months has had the greatest improvement in customer satisfaction, and that has been the situation over the last two years.

So, if I felt that we were in a situation where our organisation had problems that were systematic around targets that were too high or whatever, it would firstly show up in the people engagement scores, which would not be as strong as they are. It would follow that we would have poor customer satisfaction because customers would feel that they were being oversold. Another metric that confirms that is that three years ago we had 32 per cent of the complaints that were being made to the Banking and Financial Services Ombudsman out of a market share for us which was around 24 to 25 per cent. So we were overrepresented in complaints to the banking ombudsman. I am pleased to say that today we have a percentage of complaints made to the banking ombudsman which is less than 18 per cent. So we have seen a reduction from 32 per cent to 18 per cent, which again is consistent with the fact that we have actually generated a very good service protocol within the organisation which is being acknowledged by our customers.

So from my perspective I think that our sales and service program has actually done a lot for our customers and certainly improved our relationships. I think it is also important to note that we run a balanced scorecard—it is not all about sales; it is about making sure that we do measure customer engagement; it is about making sure that risk factors are looked at; and it is about making sure that our people surveys are of a high level from the point of view of engagement. So it is a case of making sure that we do have a balanced scorecard across all of the dimensions that make up the measurement of our business.

**Mr PEARCE**—Thank you all for being here. I want to start off by talking about the resolution process which you put in place. It strikes me as very appropriate, and a very strong and robust process, so I acknowledge that. You mentioned that some 2,300 people or about 80 per cent are going through that. Can you give us just a brief update about how they are tracking. How are those people going? They have all gone in the front end; are they now coming out the other end?

**Mr Norris**—It is really interesting to see that last week we had, I think, less than 10 acceptances of the offers that we made. This week I think we are up by 40 already, from the point of view of going from 10 to 50.

**Mr PEARCE**—So there are resolutions being produced?

**Mr Norris**—Resolutions are, now that they are agreed, taking effect.

**Dr French**—Perhaps I can give some detail in relation to the scheme as it is an area that I oversee. As you might imagine, when we first started to speak to the Storm clients in the early part of this year, particularly me, we heard some fairly dire stories. A lot of people were deeply upset and some were quite traumatised. There was a bridge that we had to cross between the perspectives that they were offering and our understanding of their circumstances. We sent a team of about 40 or 50 people up to Townsville and they have been there now for about eight months. They been interviewing clients one by one and talking to them. I have done the same—I spoke to several hundred of the clients and have gone up and presented at regional gatherings. Now we have probably presented to more than half of the Storm clients individually.

We established a scheme that has at its core a requirement for an independent decision maker. I think that is critical to being able to address a lot of the questions that the committee has faced over the last hearings. Fundamentally in order to come to a ‘landing’ on some of these quite contentious issues we need legal expertise and we need a process that is transparent, that is free and available to customers, and that is expeditious so that we will be able to get the outcomes the customers need without the requirement for a long and involved process.

As I am sure you are aware, Ian Callinan, a retired High Court judge, and a Federal Court judge have made themselves available to arbitrate in the scheme. Critically this arbitration is based on a fully transparent process. So all of the documents that we have in relation to all of the loans, for instance, are made available to the lawyers representing the clients. The lawyers, by the way, are chosen by the clients themselves and are funded by the bank. Each customer of ours is now going to be represented by legal counsel. That legal counsel will have the opportunity to access a vast range of documents. It is a quasi discovery process.

Critically, as we go through the phases of the scheme and make an offer to a particular customer based on the circumstances of the lending and their current financial circumstances—because we are paying very careful attention to the plight of the customers—we will be going through an iterative process with the customer’s lawyer. We will get to a point, if we cannot come to agreement—Mr Norris spoke to 50 or 60 agreements that have been achieved in the last few days—where we have an arbitration process. Critically, that is binding on the bank. It is not at all binding on the customer, who can walk away at any time.

I am sure you would not be surprised to hear that a lot of the customers that we spoke to early were deeply cynical about why the bank would undertake this process. What were we hoping to achieve out of it? We have taken the opportunity to put all the cards on the table—it is a cards-up exercise—and say to customers, ‘This is what we want to do to resolve this in a way that preserves your rights and gives you greater transparency and openness with a robust process and an outcome that you’ll be able to achieve very quickly.’

**Mr PEARCE**—I acknowledge the robustness; it strikes me as excellent and very appropriate.

**Dr French**—Thank you.

**Mr PEARCE**—I am sure I speak for all of the committee when I say I am delighted to hear that there are actual settlements being reached. That was the purpose behind my question. Mr Norris, could you tell the committee if your relationship with Storm was any different from that of any other advisory firm?

**Mr Norris**—No. We had a wholesale margin lending business, Colonial Geared Investments, which operated differently from our CommSec business, which is a retail business which operates directly with customers. Our wholesale relationships number around 7,000. This was the only relationship that had any real systemic issues or problems; all of the others—

**Mr PEARCE**—But your relationship was no different contractually or process-wise? With greatest respect to all of your other clients, for all intents and purposes Storm was just another client and you treated them all the same?

**Mr Norris**—Storm was different; the fact is that there was the Colonial First State index fund. That was badged Storm. That is something. While we represent a number of boutique investors and they have funds on our first-choice platform, this was unique.

**Mr PEARCE**—In terms of the badging?

**Mr Norris**—In terms of the badging.

**Mr Narev**—Although the underlying fund was in the scheme of things a relatively low risk index fund which was offered to others.

**Mr PEARCE**—But it was just a generic platform fund, wasn't it? You were just badging it for them.

**Mr Cohen**—It was an index fund that was badged Storm.

**Mr PEARCE**—Because you offered it to other people badged something else.

**Mr Cohen**—Yes.

**Mr PEARCE**—So, in essence, there was no differential contractually and process-wise?

**Mr Norris**—Not that I am aware of. I would have to take advice on that.

**Mr Comyn**—The only thing that was different was the 80 per cent LVR. I think the chairman referred to that as 'special conditions'. There was no difference in the buffer. There was no difference in the margin call clearance. There was no difference in the way the accounts were opened, established or maintained.

**Mr Cohen**—To clarify: perhaps the only other distinguishing feature is that it is not the case that we are a corporate lender to every one of the dealer groups that we deal with. In this case, we were a lender to Storm.

**Mr PEARCE**—In their own right.

**Mr Cohen**—Yes.

**Mr PEARCE**—But you dealt with that through your private backing arrangement.

**Mr Cohen**—Correct.

**Mr PEARCE**—But any of the other advisory firms could have applied to your fund.

**Mr Cohen**—They could also have done that. Some of them, no doubt, probably do have relationships.

**Mr PEARCE**—Mr Norris, if we take a step back from the ins and outs of the arrangement, at the end of the day we are mere legislators in this place and we have terms of reference for this inquiry that covers about 10 points. I would be very interested to know, based on your experience—and by that I mean your general banking experience and also your experience with Storm—what recommendations you would make to the committee in relation to the law being changed in ways that would strengthen consumer protection going forward but at the same time ensure that regulatory burdens do not become prohibitive and therefore pass costs on to consumers et cetera. That is always the balance: consumer protection, regulatory burden and making sure that it is efficient and that resources are directed in the right areas. Do you have any suggestions as to what the committee could recommend in its final report that would achieve those things?

**Mr Norris**—From where I sit, looking with the benefit of 20/20 hindsight and not having had any real exposure to Storm until very late in the piece, I question the model that Storm had, which effectively was one size fits all. I have concerns around whether or not that model was appropriate for a number of the people that were participants in that model. From the point of view of the style of advice, there are issues such as: was this ever an appropriate advice model? I have some issues in and around that, particularly when you look at the issues of double leveraging and the like.

**Mr PEARCE**—Are you suggesting that the committee could recommend that certain models be prohibited in Australian financial services?

**Mr Norris**—In assessing whether or not a financial adviser is qualified to be an adviser or whether a model is appropriate, there should be a review or some degree of analysis as to whether or not it is an appropriate advice model to follow.

**Mr PEARCE**—In your opening remarks, I think you spoke well in terms of directing your thoughts. If I recall accurately, you touched on and identified four groups of people that had to take some responsibility: you, the customers, Storm and the regulator. Part of our scope is to look at what sorts of changes could be made in relation to the role the regulator might play. Can you share any thoughts with us about your perspective on that?

**Mr Norris**—Obviously hindsight is a great lens to look back with. You can do a lot of things and make sure that you avoid mistakes with 100 per cent accuracy through hindsight. My view is that all of us need to look very closely at what has happened and ask ourselves the question, whether we be banks, financial advisers or a regulator: what could we have done differently to have made sure that this particular situation did not occur. We as an organisation have gone through and are going through a range of reviews which are about understanding where we should have looked more closely at the relationship with an organisation such as Storm, what we should have done in regard to our customers, what we should have done in regard to making sure

that procedures and policies were appropriate and also understanding why we ended up where we did from the point of view of individual culpability and where the failures were in our management structure.

**Mr PEARCE**—Have you made many changes?

**Mr Norris**—We have made a number of changes in regard to policies and procedures in and around lending. That is something that has been looked at very closely. Our valuation system, VAS, has undergone a significant review to make sure that the controls around that system are much tighter than they were previously. We have also looked at the issues in and around the management structure and what happened from the point of view of front-line management right through to the management that reports to me and includes some of the people sitting around this table. From that perspective we have been very rigorous in trying to get to the bottom of how we could have avoided this and in making sure that we can take the learnings from this particular event and apply those to the future so we do not get a situation like this recurring. It would be somewhat inappropriate for me to comment specifically around what the regulator could do, which is what you are effectively asking me to do. The regulator is obviously well qualified to look at its own situation and come to an assessment as to how or what it could have done to have seen a different outcome.

**Mr ROBERT**—Mr Norris, thank you for coming along, for your opening statement and for the model you have come up with to assist people, especially using Justice Callinan. Having come from a family that went through a foreign currency crisis in the 80s, it is refreshing to see a bank accepting responsibility.

**Senator WILLIAMS**—You are speaking for you, aren't you?

**Mr ROBERT**—I am speaking for myself only. So thank you for coming along. When I spoke to Chairman D'Aloisio of ASIC regarding the concept of good faith, I put this to him in trying to get an idea of what he defined as good faith. I said: if an organisation treated everyone the same, in terms of whether they were a wealthy or self-funded retiree or a grandmother who earned nothing, and they leveraged all their assets, including their house, and the LVR was approaching 90 per cent, and then any returns unrealised they leveraged again—that is, they superleveraged themselves—would that be an example of an adviser operating in good faith? The chairman said no, after pausing and considering for a little while. Cognisant that such an example would represent Storm's model, I think, to a T, the question for the bank is this. When did you realise you were dealing with an organisation that was not dealing with its clients in good faith?

**Mr Norris**—Certainly from my perspective I did not realise that because I was not aware of the Storm relationship until probably late December. I went away on leave in late December and the early part of January. I came back and thought about it and thought, 'We need to dig deeper into this.' That is why we as an organisation have put in place the resolution scheme that we have. I did not feel comfortable that we had a very clear understanding of exactly what the situation was and what our involvement was. One issue we have here is the fact that banks have grown over time with old-style legacy systems that were built around products rather than around customers. Identifying linkages between different product groups and customers has not been a simple exercise for banks because of these old-style systems. Most banks in the world still operate on these old-style legacy systems and most of the banks here in Australia do as well.

We are in the process right now of spending nearly \$800 million on a new computer system that is going to be customer oriented so that we will not get ourselves into a situation where we do not know the customer linkages between different sorts of products.

Colonial Geared Investments, for example, is a business that was acquired with Colonial back in 2000. The home lending was being done through the home lending system, which is part of the old legacy system. From my perspective, one of the critical investments for us going forward is to make sure that we have the best information systems available in order to make sure that we are well and truly well protected against this sort of situation again. Most banks in the world operate systems very similar to what we do today. We will be one of the first major banks in the world to move to a very sophisticated information technology system that will provide us with the ability to see our customers in a comprehensive form across all of their linkages with the organisation.

**Mr ROBERT**—Cognisant that you have 40,000 employees, so no-one expects you as CEO to be across the issues of Storm, but would you have expected someone in your management structure to have actually twigged somewhere along the path that you were actually dealing with an organisation that did not deal in good faith?

**Mr Norris**—I think it is fair to say that the work that we have done in looking at culpability in this regard has led to people who certainly should have identified issues a lot earlier than they did being dismissed.

**Mr ROBERT**—Pulling the trigger is one thing. Have you been able to identify any process or systemic faults or issues within your banking structure that may assist in this not occurring again when the next bull market goes south?

**Mr Norris**—Certainly we have done a lot of work in making sure that we now have controls that would, from the point of view of our current systems, provide us with the ability to make sure that we do not end up in this situation again. This is not something that is going to be cheap for the organisation to fix. It is a situation where we are putting in place a process which is obviously going to cost a reasonable amount of money to put customers into a situation where they are appropriately recompensed for failings on our part.

**Mr ROBERT**—It should hurt.

**Mr Norris**—I do not want to see this happen again, so I am absolutely focused on making sure that policies, procedures, people and issues are all addressed. We have gone through our organisation, our customer and other organisational linkages, to make sure that we do not have another Storm type situation somewhere else in our business. So we have spent a lot of time over the last several months making sure that this was a one-off situation and not something systemic. I take great comfort from the fact that we had 7,000 relationships of a Storm type, varying in size, and all of those did not suffer the systemic type problem that was suffered by Storm.

**Mr ROBERT**—Mr Pearce asked you about regulation. I will just bring you back to your opening statement again, where you made the point that fault lay in a few corners, including regulation. Mr Pearce asked you if there was any regulation you would like, and you discussed a

few things. If I could rephrase the question: what part of the Corporations Act or the ASIC act do you believe needs to be changed, if any?

**Mr Norris**—As I said—

**Mr ROBERT**—I am just cognisant that you answered Mr Pearce in a way worthy of a great politician.

**Senator MASON**—But you are under parliamentary privilege, Mr Norris.

**Mr ROBERT**—So you are actually free to say the act is terrible.

**CHAIR**—Don't encourage him, please.

**Mr Norris**—I think I am probably better off to hand that to my general counsel—

**Mr ROBERT**—I am happy to hear from Mr Cohen.

**Mr Norris**—for a legal perspective.

**Mr ROBERT**—I saw him going to jump in to say, 'I'll deal with that'!

**Mr Cohen**—What I was thinking, Mr Robert, was this: in our submission we actually did make some suggestions as to how we, the industry, could actually help ASIC.

**Mr ROBERT**—Could I just take you to that, because you are recommending that you would like to see ASIC make comment on a licensee's business strategy.

**Mr Cohen**—Yes.

**Mr ROBERT**—Are you sure that is what you would like them to do?

**Mr Cohen**—What we actually suggested was that the industry provide information first—

**Mr ROBERT**—That is right.

**Mr Cohen**—so that ASIC actually has information that is relevant, to enable ASIC to form a view on whether the business model of, in this case, a financial advisory firm, is appropriate, firstly.

**Mr ROBERT**—Let us take that, Mr Cowan. Let us say I am Storm, and I am answering your questions. Number of advisers? I do not know; let us say 200. Number of statements of advice produced? Maybe a thousand—I am just plucking some figures from the air. Quantum funds under advice? Three billion bucks. Management qualifications? Swags of them had masters degrees in finance—the Lord help us! List of approved products? Four or five index funds, from the nation's biggest bank. Products most frequently recommended? Generally they were from across those four or five index funds. Advice or strategies recommended? Strategy documents



were produced—quite detailed—all going to the index funds. Number of clients and breakdown of risk profile within client population? That should raise a hackle. Certain information on fees charged. No trail. Upfront fees, which we like, albeit very high. Number of complaints? zero, because it has been 10 years in a bull market. If I am ASIC, the risk profile might concern me a little, but it has been going for 10 years and everything else is huge—everything else is stratospheric, in terms of all the dot points. If ASIC looked at that, in your professional opinion would they say: ‘Storm? Bugger—this is a problem waiting to happen’?

**Mr Cohen**—The suggestion was made because, in terms of advice strategies recommended—so that previous dot point is actually a key one as well—if there is a review undertaken or there is information provided to the regulator that enables the regulator to see advice strategies which are remarkably similar, notwithstanding the type of customer, then that should be ringing warning bells. That is part of the purpose of the suggestion—to actually provide that sort of information.

**Mr ROBERT**—Do you actually believe Storm would say, ‘We believe in super-leveraging everything you’ve got until your nose bleeds’? Or would they actually say, ‘We believe in leveraging funds into the top 200 on the ASX with LVRs and industry average’?

**Mr Cohen**—What we are suggesting here is not just that a broader strategy be provided but that a range of strategies for the individual customers—so across a range of customers—be provided so that the regulator would be able to see whether the strategies varied according to the risk profile and the actual circumstances of each customer. The key here of course is whether advice strategies are tailored to meet the individual needs of the customer.

**Mr ROBERT**—My final question is: do you believe it is appropriate for ASIC to be looking at financial services including a bank’s business strategy and making comments as to its appropriateness or otherwise?

**Mr Cohen**—We think in the context of financial advice it would be helpful if ASIC had this sort of information to help it make decisions and to help give it pointers as to where perhaps it needs to look more closely, yes.

**Mr ROBERT**—Thank you

**Senator WILLIAMS**—Thank you for your attendance. Mr Norris, you said that Storm was just an arm’s-length customer yet you had staff in Queensland especially there to handle Storm applications, they had to be handled quickly, Storm were demanding. That appears to me that they had some priority as far as your bank goes when you set up those staff in Townsville to actually handle solely Storm applications.

**Mr Norris**—My understanding is that was set up locally. As I say I was not—

**Senator WILLIAMS**—So locally they had priority, obviously.

**Mr Norris**—Obviously. Looking through the lens of hindsight, there is no doubt that Storm was very demanding. Storm was obviously putting pressure on our people in the Townsville area from the point of view of moving home loans to other providers. As you are well aware, we were

not the only provider of home loans or margin loans for that matter either. You have a situation here where Storm was obviously endeavouring to use a degree of competitive tension in order to have their requirements met. I think we did end up with a situation where some of our people lost sight of who the customer was. That is, they saw Storm more as the customer than the customers themselves because they were coming from Storm, they were being promoted by Storm as part of their financial advice strategy to obviously take out home loans, margin loans et cetera. I think we ended up with the situation where Townsville was a town that was heavily influenced by Storm and its investment model.

**Senator WILLIAMS**—They saw it as good business and obviously Andrew Jackson and those people employed by the bank were meeting and exceeding their targets and they became record lenders for your institution. While the market was going up everything was hunky-dory until the wheels fell off the cart and trouble came along.

**Mr Norris**—I think it is fair to say that we have a global financial crisis, the biggest crisis in 70 years, from the point of view of equity markets and what was going on internationally. So we have ended up with a very difficult situation for a number of customers because of the fact that they used a financial model that was based around leverage, which obviously in 10 years provided good returns for a lot of people, but is your enemy in a falling market.

**Senator WILLIAMS**—So would you say now in hindsight that the Storm model was simply too highly geared?

**Mr Norris**—I think there is no doubt that for some customers the Storm model was not an appropriate model. Certainly, from where I sit, I want to make sure that, where we have made mistakes and have not acted in the best interest of our customers, we will actually resolve that and that is the reason for the resolution scheme.

**Senator WILLIAMS**—I hope that is the case. I want to go back to Senator Mason when he was talking about the 11-week period. You would be an extremely intelligent man if you could name all of your staff in the Commonwealth Bank and I do not expect you to do that for one minute. Are you familiar with a member of staff by the name of Kamal Arnaout?

**Mr Norris**—No I am not.

**Senator WILLIAMS**—Mr Cohen?

**Mr Cohen**—Yes, I am.

**Senator WILLIAMS**—Is he still employed with the bank?

**Mr Cohen**—He is still employed.

**Senator WILLIAMS**—Is he still with the CGI?

**Mr Cohen**—He is still employed by CGI.

**Senator WILLIAMS**—Will he be next Monday?

**Mr Cohen**—I cannot comment on that. If I can say this much we have carried out a people review process, as you know. For the sake of those individuals and for their future careers we really prefer not talk about individual cases here because we are talking about their future and it would be best, unless it is crucial to the committee’s deliberations, that we did not have their careers in the future potentially damaged.

**Senator WILLIAMS**—I want to talk about Mr Arnaout because I think he had a vital part in Storm and I believe he finishes up next Monday, by the way. He was monitoring the levels of debt of the Storm clients. As reported in the paper on 18 September he contacted Storm and said: ‘Things are looking sick. You have so many customers heading to margin call.’ Then the report says:

Five days later he sent her—

Ms Richards—

an email describing Storm and CGI as a “team” or “joint venture” dedicated to actively managing margin loans.

Obviously on 18 September Mr Arnaout is very aware of the LVRs of clients and it is not till later on that he has emailed Storm and said, ‘If you don’t bring them into margin call, we will do it tomorrow’—I think that was in late October. I get to the point made by Senator Mason that it is December when they are sold up. The clients did not know. What I am saying is that the only safety net they had was to be pulled out while they had some equity left in their whole savings. That did not happen. Do you think that as legislators we should look to see where, in the case of margin loans, the clients must be contacted? This has been the argument all over. The plan has changed between 2003 and 2008 but I do not think you have a document with Storm saying, ‘We’ve changed the rules.’ If you do not have a document, that is very unusual for the Commonwealth Bank in my experience with it. I have boxes of documents at home from my foreign currency loan dispute with you.

What I am saying is that things are vague here. We have had the blame game to this committee all the way through: banks are blaming Storm for not activating the margin calls; Storm are saying it is the banks’ fault; and the banks are saying they changed the rules between 2003 and 2008. They are not quite sure when they changed them, Mr Narev, not to have something signed—and were the clients notified? To me, this becomes one big stuff-up, if I could put it that way.

**Mr Cohen**—To address your point of whether there should be some legislative change, as we said in the previous appearance—and as Mr Norris said in his opening address—going forward we do propose to notify customers directly. It is interesting to note that the legislative change around margin lending still leaves open the option for the customer to choose whether to receive notification from the financial adviser or from the actual lender. In our view, frankly, if we are going to be making change to the margin lending legislation why not go the full step—and that is certainly what the Commonwealth Bank proposes to do—and actually make it mandatory for notification to be made to both customers and financial advisers, if a financial adviser is involved.

**Mr Narev**—May I add one other point which I think is very important. As Mr Cohen said, our practice will change. The other critical point, though, for the committee to consider here in its deliberations, going back to my response to Senator Mason's question, is the additional question of what will the customer do when he or she receives the margin call. There are a range of options, some of which could actually result in an unadvised customer posting more collateral and being in a worse position than they had been before the margin call.

**Senator WILLIAMS**—Yes. People such as Sean McArdle that I have spoken to in Queensland—he was one who had funds and could have done something, but all he got was a letter saying, 'We've sold out.' He was a bloke who found he automatically had a half-a-million extra loan on his book without having been notified of it, which to me sounds very strange. I have a copy of a document here going back to when Colonial Mutual sent a margin call to their client, and there is a letter here to Emmanuel Cassimatis saying: 'The following letter has been sent to the above-named borrower and also the guarantee ... It is for your information only.' This is back in those days when you actually notified the client and sent a copy to the adviser for their notification only, for them to see the point. Surely, one thing that must be addressed is this question of clients just getting a letter saying they had been sold out, the LVR is 140 per cent, they have lost all their shares and investment value, they look like losing their house, and they did not know anything about it because of a communication breakdown or inactivity through the line of communication. That must be one of the critical things you must address.

**Mr Norris**—We have made it very clear that we are going to take the view that we should notify both the adviser and the client. That will be our practice going forward. As I said at the outset, we want to make sure that this situation does not recur. We have a situation that up until now has been pretty much industry standard: advisers are the ones that are advised where you are using a wholesale process for margin loans. That has been the case with around 7,000 other dealer groups that we have operated with—that is, individual financial planners and groups of financial planners—and that has worked satisfactorily. There were significantly greater numbers of margin calls being made to those clients over this period, and we came through that appropriately. There seems to have been only one group that caused any problems during this period, and that was Storm Financial. I think you would find that there has been a similar situation with other margin lenders in their interactions with Storm.

**Senator WILLIAMS**—Is Mr Clothier boss of CGI?

**Mr Cohen**—He is a senior person in CGI, yes.

**Senator WILLIAMS**—Did he notify anyone in the credit department not to act on Storm customers? I have been told by one of your employees that Mr Clothier directed someone in your credit department not to sell up the Storm customers. That has been explained to me as one of the reasons that these people were not pulled out earlier. Do you know whether that is true?

**Mr Cohen**—I cannot comment on that. Perhaps one of my colleagues can.

**Mr Comyn**—I am not aware that that is true. Mr Clothier would not have the delegation to be able to make such a request.

**Mr Norris**—I would be surprised if our risk people would take that as an instruction.

**Senator WILLIAMS**—Is it true that in Townsville, when things were getting quiet towards the end of 2007 and in early 2008, people in the Commonwealth Bank went on to the VAS system, checked that there was more equity and then forwarded that spreadsheet to Storm saying, ‘These clients have more equity’?

**Mr Norris**—I think we spoke to that earlier on. My understanding is that the spreadsheet came from Storm; it did not come from the Commonwealth Bank. It came with instructions from Storm that their customers were wanting to borrow more funds in order to increase their investable funds. Is that right, Mr Comyn?

**Mr Comyn**—Yes.

**Senator WILLIAMS**—The Commonwealth Bank would have put that spreadsheet together on the VAS, wouldn’t it? You had the VAS. Storm would not have had the VAS system.

**Mr Norris**—No, the spreadsheet came from Storm.

**Mr Cohen**—The spreadsheet was a list of names and properties.

**Mr Comyn**—It also had an owner’s estimate. The VAS system is a decisioning system. It tells you whether the value of the home that has been provided by the owner requires external valuation or is acceptable from a decisioning perspective. We would have received those spreadsheets. They would check the value and whether an external valuation was required. There was no identification of equity, and I understand that some of those spreadsheets were returned.

**Senator WILLIAMS**—Right.

**Dr French**—Senator, we will be very closely addressing the issue of the resolution scheme of which you are aware. We will be getting robust evaluations of the security properties for home loans and ensuring that when we are recrafting those loans—looking again at the detail of the loans—the property value that is assigned through the valuation process is very robust and conservative. That is what will be using to craft offers to individual customers, and that is what we have done so far. So the valuation system that you mentioned has already been addressed in the resolution scheme and we are getting outcomes based on reconfiguring our look at that particular security property.

**Senator WILLIAMS**—How is settlement progressing with these customers that you have problems with? The feedback I am getting is that the offers being made by the bank are not good at all. Have you settled any of them?

**Mr Norris**—Yes, we have.

**Senator WILLIAMS**—How many?

**Mr Norris**—Fifty-three customers, I think, as of today.

**Dr French**—Yes.

**Mr Cohen**—That is from a situation where, having put the scheme together, we gave it a serious nudge last week because that was when we were able to get going. We expect that it is going to be a take-up of around 40 settlements per week.

**Senator BOYCE**—I just want to go back to who heard about the margin calls. Both Macquarie and you have made the point that Storm insisted you contact them and not the client and that this was the industry average. I want to put a proposition to you and then ask you to speak to it. The reason this was seen as a positive thing was that it ensured that the client was getting some advice about how to behave, given that they had received a margin call. Was there any sense at the time that it could have a sinister side, which it appears to have subsequently had with the Storm clients?

**Mr Norris**—I do not really know. I think it is fair to say that you can look at it in two ways. One way is that it was attempting to hide information from the customer—

**Senator BOYCE**—Or attempting to assist decision making.

**Mr Norris**—Yes, or assist decision making. I had not actually thought about that until you posed the question. It would be very speculative, but you could draw that conclusion.

**Senator BOYCE**—The phrasing that both you and Macquarie used prompted me to think about this potentially sinister side of the margin calls and the fact that we have had comments from Mr Roberts around changing that.

**Mr Cohen**—It is fair to say—and this was certainly our experience when we were in contact with the Storm clients who had not met margin calls, understandably from our perspective, and I think understandably from the client perspective—that those clients when contacted by us said, ‘We want to speak to Storm before we take any steps.’

**Senator BOYCE**—Because they were in the position of continuing to trust Storm at that time?

**Mr Cohen**—Yes. But in fairness to those customers, they had received initial advice about the strategy and they would naturally seek to approach the adviser who had advised them to go into the strategy about what to do next. I think that, from CGI’s perspective, the purpose of contacting the adviser was in order to ensure that there was advice. As Mr Narev has previously said, there can be several ways to go and some of them are disadvantageous depending on market movements. Certainly our take on this was that it was a positive rather than the negative that you mention. But, yes, I can see that.

**Mr Narev**—In terms of how much of this was germane to Storm, in the period that we spoke about when we made just over 2,500 margin calls between October and December to Storm customers, we made over 16,000 through the same business to clients through other dealers.

**Senator BOYCE**—Are they proportionate? Are those 16,000 customers the same percentage as the 2,500 is of the Storm customers?

**Mr Narev**—I would have to take that on notice.

**Senator BOYCE**—If you could, it would be useful to know whether that was the case. You talked about having gone through your other 7,000 dealer relationships. Have you terminated any other relationships?

**Mr Norris**—Not that I am aware of.

**Mr Comyn**—No.

**Mr Narev**—No.

**Senator BOYCE**—So Storm is the only one out of 7,000?

**Mr Norris**—Yes.

**Senator BOYCE**—Are the 53 agreements that you have put in place confidential on the parties?

**Mr Cohen**—Yes, they are confidential between the parties. The arrangements that we have on reaching a settlement are subject to review in any event, even once signed—that is, if there is a superior result achieved by the regulator in any subsequent action then the offer is open to upgrade, if I can call it that.

**Senator BOYCE**—Is it confidential forever or for a time limit? I can understand that you would want them to be confidential until they are all settled.

**Mr Cohen**—They are expressed as being confidential on an ongoing basis.

**Mr Norris**—But I think it is important to note that, as we said earlier, if there is any issue around the offer or whatever, the situation is one where it does go to the evaluation committee to establish whether or not it is reasonable. And then there will be a determination of what is reasonable by that particular group made up of Justice Callinan, Justice Gyles and Mr Gotterson. Therefore, that is binding upon us and not binding on the client.

**Senator BOYCE**—I want to go back to the suggestions you have made around coming to decisions on the quality of the sorts of groups that might be offering financial advice. Is there not a danger that we could end up with the ‘ASIC model’ or the ‘ASIC models’ being the only models that are on offer throughout Australia? ASIC have already given us evidence that some less than scrupulous planners have used the fact that they have a licence to suggest something about the quality of the information that they give, whereas in fact it is just simply an accreditation system that has been followed. My concern in all this would be that, once you are asking ASIC to judge the viability of a model, aren’t you then holding ASIC responsible for anyone who ever loses money in Australia?

**Mr Cohen**—I understand the issue. Our suggestion was not that ASIC would, with the benefit of the information provided by industry, form a judgment on the viability. Our suggestion was much more around ASIC forming a judgment as to the risk weighted nature of a particular advisory model. Our suggestion was based on the fact that it would assist ASIC in making a determination whether a particular style or a particular model of advice was at the edge of the

risk spectrum. It was not intended that ASIC would form a judgment as to whether each particular licensee's model was appropriate. I agree entirely with you that that would tend to lend an endorsement, which would be dangerous. We know ourselves that some financial advisers currently do tend to brandish the fact that ASIC has even granted a licence as a quasi endorsement.

**Senator BOYCE**—As though it means something.

**Mr Cohen**—Yes, exactly. Our suggestion was much more around ensuring that perhaps the fringe at the risk spectrum could be more readily identified by ASIC through the industry, each licensee, providing the information.

**Senator BOYCE**—For what purpose?

**Mr Cohen**—Our observation has been that the failures, the more spectacular failures, if I can call it that, have been at the fringe of the risk spectrum, whether they be at the fringe of high commissions and fees or whether they be at the fringe dealing with the actual model—in this case, an aggressive double-leveraging model. Our suggestion is made on the basis of there being greater visibility without ASIC having to spend a lot more of its own money and resources—in other words, if industry provides information, which industry, frankly, readily has. Mr Pearce was talking previously about the balance between burden and consumer benefit. Our suggestion is made on the basis that each licensee actually has this information readily available within their own databanks. It is not a burden to produce it. I acknowledge that—

**Senator BOYCE**—It has to be assessed.

**Mr Cohen**—it would be an additional burden on ASIC to be reviewed.

**Senator WILLIAMS**—14,000 of them.

**Mr Cohen**—Correct. But the point of the suggestion is that it is reasonably observable as to which financial licensees are at the fringes. The vast majority of financial planners are there in the middle; they are not at the fringes. Although I take your point that there are 14,000, it actually would not require a review of every single one of those 14,000.

**Senator BOYCE**—What is ASIC doing then—issuing a licence that says, 'This company has high-risk products'?

**Mr Cohen**—No, the purpose of this suggestion is to enable ASIC then to at least get early warning signs.

**Senator BOYCE**—To monitor?

**Mr Cohen**—To enable it to better monitor, yes. It is an early warning system, essentially.

**Senator BOYCE**—Thank you.



**Senator McLUCAS**—Can I pick up on that early warning system, because I had question along those lines. Are you suggesting that if a staff member at the CBA had concerns about the model, and I think it is evident that you did have staff who were concerned, then they would be able to whistleblow—that is not the right word, but in that vein of whistleblow—to ASIC? Is that the right place for that to happen?

**Mr Cohen**—That was not the thinking behind our suggestion. Our suggestion was really that every licensee would on an annual basis submit this type of information to ASIC as an automatic event. It would be a process of licensees offering up all information on an annual basis rather than on a whistleblowing basis.

**Senator McLUCAS**—It was put to us at the Cairns hearing that there were a number of licensed financial planners who were very aware of what was happening, were very worried and did not know what to do about it. I think there is a policy response to that somewhere. You have these people who are certainly competitive, and a competitor may whinge about someone else in order to gain market share, but in this case it would have been useful if somebody could have been alerted to the fears that were held in the mainstream financial planning industry and for someone to have a look. Do you have any views on that?

**Mr Cohen**—I agree in principle. I suppose that facility exists already in some fashion—

**Senator McLUCAS**—I am not sure it does.

**Mr Cohen**—If somebody does have a concern, they are free to go to ASIC presently and raise that concern, whether it be a competitor or, as usually happens, a customer or an investor. The consumer is usually the source of most complaints. So I suppose to a degree that happens. It is probably not something that people within the industry readily do in respect of another person in the industry. I think that would be a fair statement. Perhaps there is not the encouragement to do that in the industry, although I think it is fair to say that you would have heard via IFSA and the FPA that, as part of the effort to professionalise the industry to a greater extent than it currently is, there is a movement to try and weed out the fringe dwellers, or those at the edge of the spectrum, for the good of the industry as a whole.

**CHAIRMAN**—You make some interesting points, gentlemen, about fringe dwellers and those at the edge of the fringe. Obviously you are referring to Storm and others like them. You say that you had 7,000 dealer groups you worked with, and Storm was just one of them. Yet they represented the largest revenue out of all of the 7,000. Would you say that Storm was at the fringe, given they were your largest revenue base out of your 7,000 dealer groups?

**Mr Norris**—Certainly, from my perspective, if I had known what the Storm model was, if I had been aware of it—

**CHAIRMAN**—Can I draw you to that, because it is a fact that CBA did an internal review of the Storm model and the business model. It passed with flying colours. An internal review was done, a report was done—as banks do in terms of models, businesses, people they have relationships with—so I find it difficult to comprehend and understand that you say that it should be ASIC's responsibility to do all of these things, yet your bank actually did that. I say to you that Storm, in this case, was not a fringe dweller. It was, of your 7,000 dealer groups, your No. 1

group. It was not the fringe; it was the No. 1 group. You had done an internal review and, for all intensive purposes, it was as much CBA and CGI as it was Storm.

**Mr Norris**—Certainly, as far as any review is concerned, I was not aware of that review. I understand that there was a review undertaken in the early part of this decade, if that is the review that you are referring to.

**CHAIRMAN**—There was an internal review done in terms of the Storm business model.

**Mr Norris**—It was in 2002. I joined the organisation in 2005, so I obviously was not aware of it.

**CHAIRMAN**—Sure, but it is significance in the sense that Mr Cohen talked about fringe dwellers, particularly those that are aggressive with double leveraging and so forth. This is all information that you had at hand. Why was the Storm model so acceptable that they were your No. 1 revenue base out of your 7,000 deal groups right up to the point when everything failed and collapsed?

**Mr Cohen**—Chairman, your description of it suggests that perhaps there was a widespread knowledge throughout the bank of the Storm model. The review that you are talking about was in fact a review that was carried out in order to consider whether it might be appropriate to make some sort of investment in Storm itself. It was not a review carried out by CGI. It was not a review carried out by the home loan team.

**Mr PEARCE**—Was it a due diligence review?

**Mr Cohen**—It was a due diligence review.

**CHAIRMAN**—And what was the outcome of that due diligence?

**Mr Cohen**—And the outcome was that there was no investment made in Storm.

**CHAIRMAN**—So it was okay for your customers to invest through, but not—

**Mr Cohen**—This was an investment in Storm, the business itself—in the Storm entity itself.

**Mr Norris**—An equity investment.

**Mr Cohen**—An equity investment. So the due diligence was not a review into the model of Storm and how it actually involved the customers. It was a review into the equity investment in Storm, which is quite a different sort of review.

**Mr Norris**—I have to make the point again that I was so concerned about this that I came to the conclusion that we had to do something about it from the point of view of our customers. I am not proud of the relationship that we had with Storm. I wish that I had known about it a lot earlier. If I had known about it I would have hit it on the head.

**CHAIRMAN**—But what I am questioning now is the view put forward in your submission. Mr Cohen was just explaining that ASIC should be able to make these determinations. How is it going to be possible for ASIC to make these determinations if your bank, which has a stake in this, a high-level financial stake, cannot make those determinations? Submitting information which says, ‘This is what we do. This is our model. Our model is to gear people into Commonwealth Bank products and Colonial Geared Investments index funds’ is not going to ring too many alarm bells for me—the Commonwealth Bank, Colonial Geared Investments.

**Mr Cohen**—I agree with you.

**CHAIRMAN**—So how do you contend that that is a possible resolution to issues at hand if, for one, your own organisation, which is much closer in a business sense to what happened, did not see it either?

**Mr Cohen**—The solution we put forward is a 2009 solution. The review that you are talking about is a 2002 review.

**CHAIRMAN**—No, I am not referring to that review at all. Please discount that. That is done, past, and I accept what you have said. What I am saying is: what you have said now, your submission now, is that a way through this is just to give ASIC that model review approval mechanism or that everyone just submit to ASIC. What I am saying to you is: if you, the Commonwealth Bank, with a long-term, 10-year plus relationship, could not pick it up—

**Mr Cohen**—I see.

**CHAIRMAN**—You have described it as aggressive and double geared. Obviously, people within the bank would have understood that that was what they did. It certainly was not a secret. But if you could not see that as business operators and their major financier—out of 7,000 dealer groups they were your largest revenue base—how do you expect ASIC to see it? I am just questioning your solution.

**Mr Cohen**—My response to that is that the information that we have suggested that each licensee provide is actually quite detailed information. I know that goes to the suggestion from Mr Robert that perhaps that makes ASIC’s job harder, but the information that we are talking about is actually information about the model recommended to clients, their risk profile, the number of clients et cetera. That is information that we at Commonwealth Bank did not have access to. We did not get to review statements of advice. We did not get to see the individual strategies recommended to each customer. What we are suggesting is that industry actually provide information, which obviously could not include copies of every statement of advice but could at least synthesise information. That would at least, we think, raise some early warning signs or put people on alert as to whether there should be further inquiry. That is really the purpose of it.

**Senator MASON**—The chairman raises an interesting point. I am someone who does not come from a finance background. This is really about a sort of silo mentality. There is a report from 2002 that no-one knows about—and I am sure you did not know about it, Mr Norris; I am not suggesting you did—and also the fact that CGI was margin lending and it did not know about other loans the bank was giving to customers. I am not suggesting that is wrong, but to me

it seems nearly ridiculous that the same company did not know what one part of it was doing. For us, that sort of silo mentality is very difficult.

**Mr Norris**—Certainly, the issue here is that again you have the situation where it flowed over different business units, different businesses in the organisation. Certainly, as I have said, we are absolutely focused on making sure that the lessons learned from this are well and truly applied to make sure it does not happen again.

**Senator MASON**—Connections between the silo. I will be very quick. I just want to put together a couple of bits of the jigsaw then I have a question on legislation. When did the CBA originally raise with Storm the issue of the lack of action in relation to margin calls? When did you say to Storm, ‘Hey, what’s happening with margin calls?’ When did that happen? Do we know that?

**Mr Cohen**—There was an email from us on 18 September.

**Mr Comyn**—That is right.

**Mr Cohen**—One thing I omitted to say when you were asking questions about the 11-week period was not all 2,600 margin calls were made at once.

**Senator MASON**—I know that. It was over a period.

**Mr Cohen**—It was over a period, yes. The initial email I believe was on 18 September.

**Senator MASON**—When did you start to raise specific concerns about lack of action? I know from the Sydney hearing that Storm sent emails and correspondence to the CBA throughout October claiming to be working full time on progressing margin calls. Was the CBA questioning the response to margin calls in October? In other words, they were responding to a request from you; is that right?

**Mr Cohen**—Yes, and there was daily contact, whether by email or by phone, between the CGI and Storm from—and Mr Comyn can correct me if I have this wrong—23 September onwards.

**Mr Comyn**—That is correct.

**Senator MASON**—From then? From 23 September?

**Mr Cohen**—Yes. There were daily conversations at least and in some cases emails as well.

**Senator MASON**—I think Mr Cohen commented today and perhaps in Sydney on the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009. Is that the bill that has just gone through?

**Mr PEARCE**—Monday night.

**Senator MASON**—Given that a client can now select whether to be contacted directly by the bank or through their financial adviser this problem can happen again. I know you have changed your approach—I understand that, Mr Norris—but that is not actually going to solve the problem, is it?

**Senator WILLIAMS**—That is a job for the Senate.

**Mr Cohen**—Not necessarily—

**Senator MASON**—But you see my point. Is that right?

**Mr Cohen**—Absolutely. We agree. Frankly, our suggestion has been that, if the legislation is going to go this far, why not take the next step, to be perfectly frank, so that it is actually a mandated step to notify customers directly as well as advisers?

**Senator MASON**—Indeed. In effect, adopt the CBA model, your new approach; is that right?

**Mr Cohen**—Yes.

**Senator WILLIAMS**—In 2008 did you start to contact the customers direct of margin calls?

**Mr Narev**—Of other dealers or of Storm?

**Senator WILLIAMS**—Storm.

**Mr Narev**—Not till December.

**Mr Cohen**—In early December.

**Senator WILLIAMS**—From December then on you contacted customers to say that you were in margin call and you just bypassed Storm?

**Mr Cohen**—Correct.

**Senator WILLIAMS**—I am aware of one customer—Terry Brett, I think his name was—who had two facilities: one was a substantial amount of money and the other was a little bit of money. He got a margin call for the little bit of money but not for the big bit of money.

**Senator BOYCE**—That would be a worry.

**Senator WILLIAMS**—It is a big worry. I do not want to name the figures here for confidentiality reasons, but I know he got a margin call on a small amount of money, the value of a Holden car, but on the big one he was not notified at all. I find that concerning. Let us hope that we do not see this again.

**Mr Norris**—Certainly that would be addressed through the resolutions scheme.

**Senator McLUCAS**—I want to go back to the suggestion that there be an annual audit of product and practice—is that right?

**Mr Cohen**—Yes, it does include what is actually advised, so the advice product.

**Senator McLUCAS**—I am just trying to tease out in my mind how that would happen. That possibly would have picked up the flaws in the Storm financial system, but if you are a mainstream financial adviser and you follow the know-your-client rule the advice you would give to every client would be totally different, and should be. I just do not know how you could audit that diversity of advice because you cannot encapsulate it in any one thing.

**Mr Cohen**—Our suggestion, Senator, is not that there would be a blow-by-blow description of each piece of advice given or received. That would not be practical. Our suggestion is that in fact what can be given—and bear in mind this is as an early warning sign only, it is not determinative, it is purely as a guide perhaps to where further investigation should be carried out. Our suggestion is that the sort of information be, if you like, summarised or synthesised information and when it comes to individual clients our suggestion is that perhaps the type of strategy, the number of clients who are advised that strategy and in fact the number of clients who, for example, are rated by the financial adviser as willing to take high risk. Our sense of this is that information was provided by a particular financial adviser that 95 per cent of their clients are rated by that adviser as being willing to take a risk, that could be a potential early warning sign that might need follow-up.

**Senator McLUCAS**—That by itself is probably a simple ‘run the ruler over’ type of measure.

**Mr Cohen**—Exactly.

**Senator McLUCAS**—We have been urged not to make recommendations to legislate to stop one event, that that is a poor way of making a regulation.

**Mr Norris**—I can understand that. I mean, we are in a situation where there has been a failure of one dealer group which has been in a financial crisis that is the worst crisis internationally in 70 years and probably the most significant fall over an extended period of equity prices since the Depression. So I can understand the view that this one particular occurrence triggers a range of reactions that are out of proportion to what has happened. That is not minimising the fact that a lot of people have been hurt by this, but if we look at it across the total financial planning industry, the system has actually come through in pretty sound shape. But we do have a situation where we have had obviously the Westpoints, Fincorp, we have had this situation, and it is a case of are there elements of these sorts of models that you can clearly identify that these are at the fringe. I think the situation with Storm was that the benefit a lot of people had was that those who had taken the advantage of leverage on rising markets for an extended period of time obviously have done quite well and believed in the model.

**Senator McLUCAS**—Just for accuracy on that, they did quite well on paper but, because they kept tipping it back into the bucket—I have not met a person who has come away with money, and I live in North Queensland.

**Mr Norris**—I agree.

**Senator McLUCAS**—It is almost that quick and dirty look at the business plan that would have identified, in retrospect, that this model was not going to work if we had a crash of any proportion. We need to have some system of identifying early.

**Senator WILLIAMS**—Mr Norris was talking about the global financial crisis being the worst for 70 years and you have obviously given us a clear message here that you have learned a lesson out of your experience with Storm. Let us hope those financials around the world who actually brought on this global financial crisis through subprime lending and reckless lending have learnt the same lesson so that we are not back in this position in the near or distant future. The whole thing comes back to reckless lending and unsecured lending, and when things turn sour, whether it be Storm or whether it be the subprime in America, this is what has brought the globe to its knees economy-wise.

**Senator BOYCE**—I do not think human nature is going to change.

**Senator WILLIAMS**—I think what is going to happen is that we do it all over again in 20 years time.

**CHAIRMAN**—Before we stray too far away from the particular issues at hand, I think the committee has dealt with all the questions and we thank you for the time you have made available to us tonight. I wanted to clarify something in the evidence Mr Cohen gave in Sydney in answer to my question about whether the terms of the bank with Storm Financial were just run of the mill, ordinary, in the sense that you provided Storm with a specialist team and also their own BSB number. I have got it in front of me. You say that identifies Storm customers. I just thought you went to a lot of trouble. You explained that this was pretty normal. You said that the BSB number was not for the margin loans, it was just for home loans. Did you mean home loans, home equity loans or new home loans? What sort of home loans?

**Mr Cohen**—That BSB was created in August 2008, so in a relative sense quite late in the piece—

**CHAIRMAN**—Very late.

**Mr Cohen**—compared to the overall association we had with Storm. It was for home loans, it was not for the CGI market ones.

**CHAIRMAN**—So for purchasing homes.

**Mr Cohen**—Sorry, when I say home loans it could be either a brand-new loan to purchase a home or it could be an additional or a top-up loan based on the security of a home.

**CHAIRMAN**—That poses more questions for us. It is pretty obvious that Storm never once recommended anyone to purchase a home. In fact, they did the exact opposite. They went out and stridently told people to rid themselves of this type of asset and to only use it as a base for further borrowing. So I am assuming—I am pretty well know—that all of those loans were not actually home loans. That is why I am questioning whether—

**Mr Cohen**—Also refinancing with an existing other financier who was then financed in time.

**CHAIRMAN**—So is it normal, then, that you would provide a BSB? Was this a new policy?

**Mr Cohen**—That was not normal.

**CHAIRMAN**—It was not normal. Okay. That at least less makes sense.

**Mr Norris**—And I think it is fair to say that I do not think it was used to any great extent because—

**CHAIRMAN**—It was right at the end.

**Mr Norris**—It was August of 2008.

**CHAIRMAN**—Thanks very much. As I said before, the committee appreciates your time and your assistance. I also want to thank Hansard and all the committee members for all their assistance during the public hearing process. I adjourn the committee.

**Committee adjourned at 8.26 pm**