Putting a human face on the Financial Services Industry:

What happens when it all goes wrong?

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Why this topic?

An interest in the human side of the financial services industry has morphed into a PhD topic. Could be called “getting behind the numbers” – I prefer to say it is “understanding what the industry exists for”.

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- Dr Tim Higgins (Actuarial) (ANU)
- Prof Tom Smith (Finance) (UQ)
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Collapse of several Australian financial service providers over 2006-2009. In particular, Storm Financial, a Queensland-based company:

- Margin lending product sold, where investment loans were set up against assets held by the investor
- Mainly sold to retirees or those close to it
- Aggressive (iterative) leveraging strategy
Example: Couple aged 65 and 60 have a freehold house worth $500k.
- Take out an investment loan of $300k against the house. Invested in a Storm “index” fund (100% equities). A 7% fee (no renewal fees) makes the loan $321k.

- LVR ratios varied, margin calls in place (in theory…), cash accounts set up to manage interest on the investment loan and living expenses. All good… when the index does what it did in the sales projections, year on year on year…

- Revaluations done → so that the investment loan can be re-leveraged up to the LVR. On the resulting new investment loan, 7% is the fee to Storm again.

- Suppose the investment grows to $500k over 3 years, house now worth $600k, but the investment loan is still $321k (LVR = 29%). So take out a new loan (X) to give a LVR of 60%.

\[
\frac{(321k + X)}{(1.1m + X)} = 0.60 \rightarrow X = 847,500; \text{ or }
\]
\[
X = 1.1m \times 0.6 - 321k = 659,679.
\]

Either way, another 7% of the extra loan to Storm, and this is added to the loan.
- What if the investment falls “lots”? (“oops” 1)
- What if the process for margin calls falls down? (“oops” 2)

→ Catastrophic losses for 14,000 investors

→ Losses range from a large loss of superannuation (700k to 200k);

→ to the more devastating impact of our hypothetical couple who had a freehold house. They also had 300k superannuation – now they have $0 superannuation, $0 cash, and owe 400k on a house now worth 500k again. And not able to work. Fairly common sort of scenario for those in the Storm model who were close to retirement.
Research questions:
1. What happens when it all goes wrong?
2. Do people ever recover from this sort of thing?
3. What are the differing views on the financial services sector, who holds them, and why?

Data
A. Subsequent Parliamentary Inquiry in 2009 had 400 public submissions – approximately 200 of these from impacted Storm investors
B. Also transcripts of 9 public hearings throughout 2009
C. The range of accepted "qualitative" data sources – documents, interviews (13 + 1), observations at interviews
D. Public meetings
E. Other media sources (e.g. PiggyBanks)
1. What happens when it all goes wrong?
What happens when financial advice (outcomes) go wrong is that people lose the ability to have control on their lives.
- Perhaps “obvious”, but multi-faceted:
  - when, why and how this happens
  - Impacts differ for a range of reasons
  - Ability to deal with uncertainty of life has gone
Lay a framework of “control” over 4 stages of the Storm fiasco

i. Considering, and taking, the advice (3 sources)
ii. When it all went downhill (Nov/Dec 2008) (margin calls)
iii. Subsequent legal offers and „settlements“
iv. Now (a waiting game for those unable to wait any longer)

A sad tale overall. Not necessarily about destitution but devastation – of plans, dreams, expectations, options, i.e. the ability to have control over one’s life and choices.

“At least with cancer, you have options and they are explained to you. With this, what are the options? Who can help?”

The irony is – “financial advice” in this context is presumably to provide exactly what has gone – options, control, choices.
Surprising findings to date:

- 7% fees are not perceived as the main problem (for those that knew about them)
- Advisors are not universally loathed by the investors (some very definite exceptions exist)
- The banks, on the other hand, are not popular. Expectations about fiduciary duty, responsible practice, honouring of agreements, simple politeness and awareness → care of the customer
- The depth of feeling and impact. It is “just money” but it’s also the means to have control or a say in your life
- The “shame” factor. Public utterances by politicians, or deafening silence, are both taken on board. Sticks and stones and words will always hurt…
- The total hollowness of “regulation” to the everyday investor. Is it protection or is it not? ASIC not on Christmas card lists
- Some positives (but not everyone). Simpler life, friendships tested, “stopped the kids asking for money”
So, overall:

The Story of Storm.
- Advice clearly inappropriate in some cases
- Upon getting advice from educated advisors, who ticked the required regulatory boxes, things went bad. “Operational issues” is a nice way to put it*.
- Widespread loss for 1000”s who are not in a position to (ever) recover
- Trust, hope, “life”, has gone for many investors

* NOTE: Class action by impacted investors against the Banks (not Storm) is being taken. Due for Court in Sep 2012 (watch this space…)

Wider implications
- Financial Services Industry offers a hugely valuable service – is it done well? What should it look like?
- “Risk”: do people really know what this means? How much should be left to individuals to decide for themselves?
- Public policy questions: Who influences who? What are the limits to regulation?