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AFTERMATH OF A STORM

Aaron Bruhn

Readers will be well aware of the many high-profile financial collapses in recent years, such as Westpoint, Opes Prime, Basis Capital, FinCorp and Storm Financial. The collapse of Townsville-based Storm Financial in early 2009 in particular provides much food for thought for individuals, advisers, regulators, credit providers, and others who are connected to the financial services industry.

By way of background, many of Storm's clients borrowed against their existing assets to allow investment into an indexed share fund. The assets which were borrowed against often included property that was already owned outright (including the family home). Investors were typically, but not exclusively, retirees or those close to retirement. Storm Financial had total funds under management of well over AUD \$4billion in August 2008, but then fell to a position in January 2009 where it had to be placed into administration. Liquidation followed in March 2009, and since then a number of things have occurred which, though seemingly with the intent to put things right or find out what went wrong, have left many investors even more frustrated and despondent about their fate. The subsequent actions include a Parliamentary Inquiry, various settlements between some banks as credit providers and some of Storm's investors, and ongoing legal action.

A number of interviews have been carried out with investors who were involved with Storm Financial. The main goal of the interviews was to understand or appreciate the perspective of 'what now for shattered investors', rather than a more investigative work into what happened, why things happened the way they did, and so on. With such interviews there are always a number of aspects to account for when appreciating an interviewee's response – indeed, feedback already received from others has centred around the expected biases that might expect to emerge with such a sample of interviewees¹. However, the focus has not been the 'why' and 'how' of Storm's collapse – but of far more interest personally is the 'what now'. For

that reason, this article is deliberately sparse with judgements about the actions of various groups involved, and rather, what follows is merely an opinion on some of the significant themes to emerge.

One thing that the sad story of Storm highlights is seemingly not the first thing that would come to mind from such an extreme case of financial loss is that the service provided by the financial services industry is hugely important to the general wellbeing of people. This may be an obvious point to those who at the coalface of the industry and who fully appreciate what the industry actually exists for, but the outcome from Storm perhaps underlies the whole rationale of the financial services industry in a roundabout way – this is that the industry is fundamentally about people and their needs, and when financial outcomes take a turn for the worse as it did with Storm, things can go very badly for those impacted, and not just financially. What this implies is what is called the 'contrapositive' statement: that for people generally to be content in their lives, their financial affairs need to be in good order². Fundamentally, when you are working, or advising, or administering, or reviewing, or planning things to do with someone's financial affairs, it is not solely one segregated area of their life that you are influencing – the entire life of that person can be enhanced or adversely impacted through such influence.

Financial situation after Storm

One noteworthy point is that although many investors have experienced nothing short of a total calamity in a financial sense, and that this should never be underplayed, a large proportion of investors nevertheless are not facing destitution – but rather, most face devastation – of dreams, plans, and the means to have control of one's choices. Perhaps destitution is not really about a certain level of wealth, but is about to what degree options and choices are available to people. This relates to the underlying role that money plays in our lives – and whilst it is true that what has been lost is, colloquially, 'just money', this is not the point – that money for many people represents the means to provide for their goals and dreams in most areas in life. In effect, it is the currency to have some control on one's choices and options.

Perhaps the most striking feature arising out of Storm is the diversity, scope and depth of the impact on people's lives. In the aftermath of Storm's and no doubt other collapses, impacts include a vastly heightened vulnerability to relationship difficulties, family stresses, health issues (particularly in the area of mental wellbeing), unease with social interaction and a sense of judgement from others, and many more 'human' factors. Many of these impacts are what could be termed 'first order' – for example, the significant stress involved in losing one's life savings and place of abode itself is calamitous enough in terms of mental health, but a range of 'second order' impacts also occur.

To continue the example of health, many former Storm investors would now not undertake medical treatments due solely to the cost involved. Even though medical treatments were formerly considered essential to their quality of life, many have also cancelled their medical insurance. And those that can keep insurance in some form often delay medical treatments to maximise entitlements net of deductibles. The lack of funds normally means therapeutic activities such as taking grandchildren out are now a guilt-ridden time to be endured. Quite obviously many of the impacts are inter-related and this underlies the fact that an individual's financial affairs are not one isolated aspect of life which should be viewed as artificially segregated from the rest of their life – their financial wellbeing has a value and importance within the overall context of an individual's circumstances, which varies from person to person.

It is a perhaps even a comment on modern day society to state that these outcomes are exacerbated and compounded where individuals face some degree of isolation. This isolation appears in many forms – a change in friendships after financial ruin, frustration from family at a parent, a brother, a sister or a spouse. In addition, there are often an exclusion from circles that were commonplace beforehand (not deliberately or pointedly so, but often where money was required to be involved), a total embarrassment at what has happened and so voluntary withdrawal from some aspect of society may occur. It is not meant to be a trite or simplified additional comment to make, but how many individuals would appreciate a neighbour, a friend, a family member being there to help or to listen without judgement – it is as important and helpful here as in any other life-changing circumstances. One interviewee made this clear when describing the gratitude felt when a relative handed over a vehicle for his family's indefinite use, shortly after his own car broke down with an expensive repair bill ahead. The implication is that acts of kindness and generosity certainly help alleviate financial pressure, but they also go well beyond that.

Trust matters

A further area of loss for those impacted is trust. The financial advisor is of course part of this, but surprisingly from interviews to date, it is not universally held that this is where the majority of the blame game lies. Two other areas of blame lie with institutions, and just as damagingly, with oneself. In the case of Storm, there is much anger and disdain held towards the credit providers (banks) where it was believed that they would provide a reasonableness check to investment loans granted to individuals and they (or Storm) would not sell up an individual's portfolio without the chance to make extra payments to keep it going; the actions (or as many interviewees have observed, the inaction) of the Australian regulator ASIC³; and even the manner in which some lawyer-negotiated settlements between investors and banks were conducted. As one interviewee has commented, "the adviser did us, the bank did us, the regulator didn't do anything, the lawyers did us – who's next?" Ongoing legal class action against some banks continues in the case of Storm. It is fair to say that a loss of trust in major institutions which make the modern world tick over is not a healthy outcome in anyone's language.

Also, many investors blame themselves – with hindsight everyone's best friend – but on top of that is the issue of moral regret associated with also advising family and friends into the scheme, or indeed being recommended to join by family and friends. If you have relied on yourself, family, friends, professional advisors, and institutions to look after you and your family's interests, and then that decision goes devastatingly wrong – it seems that all or most of these levels of trust fall over like dominoes, and those impacted really struggle to know where to turn to next.

More practically in terms of lessons for investors – one factor that seems to complicate things is the danger of 'mission creep'. According to Wikipedia, this is the expansion of a project or mission beyond its original goals, often after initial successes. In a financial sense it could be considered as 'why make gains of \$X, when you can make gains of \$(X + Y)?' What is not understood so well is the increase in risk involved in moving from gain (or goal) X, to some bigger gain. This is complicated in a financial setting because most people do not have a concrete and concise goal as such – often it is more case of see how well one can do, and as more nice carrots are held out as to what greater wealth can buy, taking the next step of more return (but unstated, or underplayed, or misunderstood, or not-really-believed higher risk) is fait-accomplis for many. This comes back to perhaps a more fundamental question of how people see their lives and involves a question which probably not many ever ask – this is, 'What will it take for me to be content?' In a financial sense, an answer to that question gives something concrete to work to and plan for. Critically, it should be appreciated that subsequently trying to achieve something other than that will involve a different degree of risk than what was initially considered.



The quote

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Risky business

The issue arising from the above point is, of course, 'risk', and the obvious fuel to throw on the Storm fire is simply to say that the investors should have been more aware of the risk involved – but this misses the point on several fronts in this case. Certainly it was a high risk endeavour and it is reasonable to say that for many people, the advice to invest in the Storm model was inappropriate – a highly leveraged product, in 100% equities, for those in or close to retirement with little options around future employment and alternative ways to derive financial security is not going to fit many people's appetite for risk. However, others may well have understood the risks, or considered the chance to turn what they perceived as a meagre superannuation entitlement into something more substantial as a reasonable option, or for others who were younger and deriving good incomes from employment, it quite possibly fitted their goals and risk appetite.

These are all very possible and reasonable positions where investors were comfortable with the loan to value ratios involved, the relative size of cash buffers built up, their interpretation of the historic volatility of the equity market, their own ability from other funds to make margin calls, and their particular investment horizon. What was more specific to Storm though, was that it does not appear to have been fundamentally a question of 'market risk' that led to an unravelling of the scheme – but more one of 'operational risk' where many investors were not even given the chance to meet margin calls because the credit providers and Storm itself, did not have things in place (or more to the point, they seem to have disagreed in hindsight who was responsible for doing so) to contact investors as loan to value ratios were breached. The first that many investors knew of problems specific to their situation was when they were rung up, by the respective credit provider, and told that their position had already been sold up or down, to be more precise.

So where an obvious critique would be to lob grenades about the nature of the risk involved, it should be borne in mind that the risk that undid Storm was not the known risk around market fluctuations, but the unconsidered (the 'unknown unknown', to quote Donald Rumsfeld) risk that the administrative process would collapse. Undoubtedly, the latter would not have occurred had the impact of the GFC throughout 2008 not pressured Storm's position with its credit providers, but nevertheless it is too easy and simplified a target to say investors were undone by the market risk they should have been more cognisant of. This does not, of course, underplay or shift focus from shortcomings around the 'one size fits all' model adopted by Storm nor the importance of understanding 'risk', but the fact is that risk has many shapes and forms.

However, a concern is that the communication of 'risk' in this context does not stress enough the downside of an investment choice. Risk aversion would suggest that the joy someone gets from making 10% on an investment, is less than the anguish suffered from a 10% loss, yet the downside risk of such possibilities is usually couched in terms which equate 'risk' to 'greater returns in the long run', or 'high volatility of returns'. These terms are unhelpful and potentially misleading in many cases – rather, 'risk' can mean 'there is a probability of ruin for you', or even more colloquially, 'things can go really bad'. This is not to scare off anyone ever taking reasonable risks, but it could put things in terms that mean something to the everyday investor and which account for the fact that a degree of

risk-aversion reigns in most people's decisions. In other words, in the context of someone seeking financial advice it should be okay to emphasise loss above that of gain in many situations. In the case of the group of Storm investors who put up their family home for leverage in addition to other assets, had they been presented with 'risk' in terms expressed as 'your chance of losing your house is x%', it is not unreasonable to say that many would have re-considered their position.

Conclusion

The story of Storm is a sad one in which thousands of investors have suffered enormous financial loss. What is lost when things take a turn for the worst in a financial sense is the ability to have control of one's life, as well as a level of trust in those things which were formerly given some trust. Sadly and ironically, the means to have greater control in one's life choices is no doubt a major motivator to engage with professionals in the financial services industry in the first place. How the industry and regulators work to build ongoing trust and assurance in the industry is no doubt an ongoing challenge. **FS**

Aaron Bruhn is aiming to write more detailed papers on the aftermath of Storm Financial's collapse in the next six to twelve months. If anyone has an interest in his work, please feel free to contact him at aaron.bruhn@anu.edu.au.

Notes

1. In particular, feedback to date from presentations to academic colleagues, actuarial conventions, and mixed audiences of regulators/consultants/academics, and from within some interviews themselves, has included views such as: "everyone has selective memories in hindsight", "don't believe everything the individuals tell you", "yes but the investors had it good for a long time", "people always want to blame someone else", and so on. The author's view is that all these comments probably apply to many people much of the time (Storm investors or otherwise), but the purpose of the interviews was not to get into the detail of why and how and who said what. Rather, it was to establish the impact on people's lives when they suffer major financial loss. A series of later (probably academic) papers will address issues around the fidelity of the interview process and findings.
2. To put this generalisation simply, if "financial affairs going bad" implies "people are sad", then for "people to be happy" implies "financial affairs need to be going well". People can certainly be sad despite having their financial affairs in order, but it seems to be a genuine struggle to cope well and enjoy life when financial affairs take a turn for the worst.
3. Aside from the fact that margin-loan based products such as that promoted by Storm did not fall under ASIC's regulatory umbrella at the time of Storm's collapse, many investors nevertheless consider it inappropriate that ASIC had private (now public) reservations about the scheme, but did not provide any specific information or concerns to interested investors.