



FINANCIAL SYSTEM INQUIRY SUBMISSION

‘A coalface solution to Product Failure’

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1- EXECUTIVE SUMMARY:-

Product failure, impaired structures and frozen funds in the Australian financial services market has exceeded \$37 billion since 2005 greatly affecting consumers' ability to save for retirement.

The previous Labor Government erroneously levelled the blame for this environment at the product commission environment in the financial advice industry and failed to address key systemic problems we believe are responsible for these catastrophic conditions.

Although we agree with most aspects of FOFA it has however not addressed the core reasons why these funds failed. Adviser behaviour certainly needed to be modified but we contend these failed funds should not have been on the market in the first place and they should have not been allowed to get distribution traction with advisers and self-directed consumers.

We are requesting that the FSI investigates and modifies the conduct and roles of Research Houses in the advice distribution process and ASIC's handling of the registration and distribution of Product Disclosure Statements [PDS] created by product manufacturers.

ASIC have publicly announced on many occasions in the past that any new PDS's are only **registered** with ASIC before market release, **they are not scrutinised** by ASIC. Unfortunately not many of us have listened. Even senior members in the industry and understandably consumers have wrongly assumed that product structure and back ground checks on key personal were performed upfront by ASIC before market release. This misconception has subconsciously been ticked off by many as the 'first filter' mechanism in the market credibility process.

The Westpoint collapse was a prime example with consumers blaming ASIC for allowing the product to exist in the first place. Many are then surprised to learn that the ASIC product scrutiny process only happens if failure occurs, this misconception by the industry and consumers has proven to be very costly.

We are not advocating that ASIC becomes a research house, we however believe ASIC should have a more active role in the management of the PDS approval and market release process, a suggested structure will be presented in the summary section of this paper.

A critical element to the success of a PDS manufacturers' distribution success is gaining a favourable rating from a Research House. Unless a product has a favourable rating they cannot get traction with the Advisers or self - directed consumers. The majority of Advisers rely upon a favourable product rating to justify a product's inclusion in a client's portfolio. This forms an integral part of an adviser's legal obligation to have a 'process' to conform to regulatory guidelines.

Unfortunately, this places Research Houses in a very powerful and influential position to dictate distribution outcomes; they are essentially the 'middle person'. Advisers need their



ratings to justify a product's inclusion in a client's portfolio and PDS manufacturers needed their approval to gain traction with the adviser or self-directed consumer.

Best practice strongly suggests that the advice industry should be the only market stakeholder funding Research Houses to avoid massive conflicts of interest and distortions with the true quality of a PDS and its manufacturer, unfortunately this is not the case. We are only aware of one Research House who has a business model where a yearly audit is conducted by an external credible party to confirm that no revenue is received from a product manufacturer to rate a product. The other 90% of the market participants accept product manufacturer payments to rate their products in various forms of activity.

This ability for product manufacturers to 'shop around' and have the distinct possibility to commercially influence their product rating, regardless of product quality is profoundly conflicted and needs to end. US Congress identified this 'shopping around for a credible rating' culture was a major contributor to the distribution of flawed structured products leading up to and exacerbating the GFC. In fact some very high profile global credit agencies are currently before the Courts to answer for their conflicted conduct.



2 - SUMMARY:-

The 164 failed or frozen funds detailed in the attachment all had one issue in common; they had all [without exception] purchased a positive rating from a conflicted Research House to get inflows from the market. This widely accepted paradigm within the industry has to end. Consumers need to be educated on the difference between a conflicted and non-conflicted business model and advisers need to be 'encouraged' to support a non-conflicted culture.

A major contributor to this culture is a lack of available retail funding to support the numerous retail Research Houses in existence. Some level of blame can be attributed to large advisory groups using their scale to significantly reduce pricing, depleting the available capital and forcing them to seek funding from product manufacturers to survive.

We believe a solution to rectify the lack of scrutiny by ASIC of new PDS's entering the market and eliminate the 'shopping around' culture for ratings is as follows:-

1. Every adviser pays an annual fee of [say] \$1,000 into a pool operated by ASIC to fund product research.
2. This pool funds a panel of Research Houses to examine new PDS's before market release i.e. business model sustainability, Director Profile and background, likelihood of success etc.
3. ASIC can essentially outsource the PDS assessment process to this panel giving the market some comfort that the PDS has been professionally assessed.

This business model will force advisers to fund research, force research houses to change their funding models, the weak/conflicted will not survive and the market/consumers will gain much needed comfort with the distribution of product and its quality.

FOFA has not addressed these weaknesses; product failure history will continue to repeat itself unless meaningful structural change is implemented.

Source – ASIC website and general market information

List of Failed and Frozen Financial Products from January 2006 to April 2013		
Managed Fund/Investment	Value (\$m) rounded to nearest million	Failed/Frozen Date
1 Aberdeen Cash Plus Fund	45.58	13/01/2010
2 Absolute Capital Group	400.00	28/11/2007
3 AMP Capital (AXA) Australian Income	76.84	1/10/2008
4 AMP Capital Australian Small Companies Fund - Wholesale	8.71	20/08/2010
5 AMP Capital Core Property Fund - Class A	19.00	9/03/2009
6 AMP Capital Enhanced High Yield Fund	67.20	10/10/2008
7 AMP Capital Enhanced Yield A	308.97	10/10/2008
8 AMP Capital Enhanced Yield H	13.27	10/10/2008
9 AMP Capital Investors Enhanced Index International Share Fund	4.78	30/09/2009
10 AMP Capital Investors Small Companies Fund Class A Units	31.49	30/07/2010
11 AMP Future Directions Total Returns Fund	0.38	2/12/2009
12 AMP Multifund Balanced Growth Fund	175.03	1/10/2008
13 APN Direct Property	26.93	1/10/2008
14 APN Diversified Property Fund	21.12	13/10/2008
15 APN International Property for Income Fund	3.13	24/10/2008
16 APN Property for Income Fund	571.89	24/10/2008
17 APN Property for Income Fund No.2	243.88	24/10/2008
18 Aspen Diversified Property	114.92	1/10/2008
19 Astarra Balanced Fund	72.19	5/11/2009
20 Astarra Conservative Fund	31.04	5/11/2009
21 Astarra Growth Fund	12.12	5/11/2009
22 Astarra Strategic Fund	118.00	5/11/2009
23 Aust Unity - High Yield Mortgage Trust	144.90	1/10/2008
24 Australian Capital Reserve	350.00	1/05/2007
25 Australian Unity Diversified Property	155.85	1/10/2008
26 Australian Unity Mortgage Income Trust	625.42	12/11/2009
27 Australian Unity Office Property	142.72	1/10/2008
28 Australian Unity Wholesale High Yield Mortgage Fund	279.85	23/10/2008
29 Australian Unity Wholesale Mortgage Income Trust	925.58	12/11/2009
30 AXA Australian Monthly Income	207.34	1/10/2008
31 AXA Australian Property	53.73	1/10/2008
32 AXA Gen-Australian Monthly Income	40.16	1/10/2008
33 AXA Wholesale Australian Income Fund	208.72	31/12/2008
34 AXA Wholesale Australian Monthly Income Fund	1,298.16	23/10/2008
35 AXA Wholesale Australian Property Fund	728.50	19/08/2008
36 Balmain (MMT) Mortgage Trust Retail	11.00	1/10/2008
37 Balmain (MMT) Mortgage Trust WS	8.24	1/10/2008
38 Balmain (MWMT) Mortgage Trust IDPS	38.22	1/10/2008
39 Balmain (prev Mirvac) AQUA High Income Fund	101.23	31/07/2008
40 Balmain AQUA Income Trust	28.46	1/10/2008
41 Banksia Financial Services	650.00	25/10/2012
42 Basis Aust-Rim Diversified Fund	213.00	31/05/2007
43 Basis Yield Alpha Fund	78.00	1/06/2007
44 Becton Diversified Property Fund	61.96	1/11/2008

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45 Blackrock Australian Quant Strategies Fund (Class D) Units	210.50	18/10/2010
46 BlackRock Combined Property Income Fund	24.26	25/08/2008
47 BlackRock Direct Property C	13.15	1/10/2008
48 BlackRock Direct Property E	35.39	1/10/2008
49 BlackRock Direct Property W	13.32	1/10/2008
50 BlackRock Direct Real Estate A	4.97	1/10/2008
51 Blackrock Scientific Australian Equity PST	611.91	15/12/2010
52 BNP Paribas Asset Management Emerging Markets Equity Fund	2.97	1/09/2010
53 BT Global Return Fund	1,200.00	19/12/2008
54 BT Wholesale Australian Small Companies Fund	508.62	13/11/2009
55 BT Wholesale Technology Fund	2.00	22/02/2010
56 Centro Direct Property Fund	1,323.04	14/12/2007
57 CFS Bricks and Mortar Fund	75.28	27/10/2008
58 CFS FC Inv-CFS Income	53.47	1/10/2008
61 CFS Mortgage Income Fund-Income	792.67	1/10/2008
62 CFS Mortgage Income Fund-Income NEF	132.29	1/10/2008
63 CFS Wholesale Guaranteed Mortgage Fund	13.00	27/10/2008
64 CFS Wholesale Mortgage Income Fund	852.00	27/10/2008
65 CFS WS Long Short Share Strategies Fund	10.18	23/05/2008
66 Challenger Wholesale Global Property Securities Fund	21.77	18/10/2010
67 Challenger Wholesale High Yield Fund	34.48	16/10/2008
68 Challenger Wholesale Hybrid Property Fund	136.40	21/08/2008
69 Challenger WS MTM Diversified Growth	0.89	8/12/2008
70 Charter Hall Direct Property Fund	165.99	1/10/2008
71 Charter Hall Direct Property Wholesale	115.96	1/10/2008
72 Colonial First State PST - Australian Share Option	7.03	16/11/2009
73 Colonial First State PST - Property Securities Option	30.01	16/11/2009
74 Cromwell Property Fund IDPS Option	472.00	14/01/2009
75 Custom Choice WS Australian Share Portfolio	0.50	11/12/2008
76 Denison (Viento) Diversified Property	35.91	1/10/2008
77 Domaine Diversified Property Fund	43.66	5/06/2008
78 DWS RREEF Global Equity Opportunities Fund	277.90	10/12/2008
79 DWS Strategic Value Fund	98.90	23/12/2008
80 DWS Strategic Value Fund (Enhanced Liquidity)	0.10	20/04/2010
81 EQT Wholesale High Income Fund	84.39	4/08/2008
82 Equititrust	194.00	1/11/2011
83 Fincorp	200.00	1/03/2007
84 Forest Enterprises Australia	393.00	1/05/2010
85 Goldman Sachs JB Were Emerging Leaders Wholesale Fund	155.80	23/04/2010
86 Goldman Sachs JB Were Global Health & Biotechnology WS Fund	8.60	23/04/2010
87 Goldman Sachs JB Were Multi Strategy Fund	1.24	14/11/2008
88 Goldman Sachs JBWere Property Securities Wholesale Fund	27.20	2/06/2010
89 Great Southern Agribusiness	4,000.00	16/05/2009
HFA Diversified Investments Fund,		
HFA High Octane Fund,		
90 HFA High Octane Fund Series 2	1,100.00	22/12/2008
91 Howard Wholesale Mortgage Fund	2,352.66	21/10/2008
92 Huon Australian Share Fund	9.93	10/11/2010
93 Invesco Wholesale Asian Share PST Fund	3.39	8/12/2008
94 Invesco Wholesale Australian Fixed Interest Fund	1.81	27/05/2009
95 Lazard Global Equity (ex Australia) Fund	1.02	30/11/2009

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96 Legg Mason Australian Credit Trust	7.12	27/01/2010
97 Legg Mason Wholesale Defensive Trust	45.89	15/06/2009
98 Lift Capital	100.00	1/06/2008
99 LM Australian Income CP AUD 1 Year	0.74	1/10/2008
100 LM Australian Income Fund	27.86	20/03/2013
101 LM Australian Structured Products Fund	8.22	20/03/2013
102 LM Cash Performance Fund	0.73	20/03/2013
103 LM Currency Protected Australian Income Fund	76.86	20/03/2013
104 LM Managed Performance Fund	376.74	20/03/2013
105 LM WS First Mortgage Income Fund Flexi Account	608.94	4/08/2008
106 Macquarie Direct Property Fund	156.40	25/08/2008
107 Macquarie Diversified Private Equity - 2002	6.64	29/09/2009
108 Macquarie Global Private Equities Securities Fund	4.54	27/04/2010
109 Macquarie Life Master Aust Enhanced Equities	45.78	25/11/2009
110 Macquarie Life Master Balanced Investment Fund	65.42	25/11/2009
111 Macquarie Life Master Capital Stable Fund	58.77	25/11/2009
112 Macquarie Life Master Cash Fund	86.87	25/11/2009
113 Macquarie Life Master Fixed Interest Fund	131.79	25/11/2009
114 Macquarie Life Master Property Securities Fund	106.49	25/11/2009
115 Mariner Wholesale Mortgage Trust	15.57	27/10/2008
116 MLC Australian Share Fund (MT)	208.43	2/02/2010
117 MLC Balanced Fund (Moderate)	731.29	2/02/2010
118 MLC Capital Stable Fund (Conservative)	298.44	2/02/2010
119 MLC Capital Stable Fund (MT)	1.87	2/02/2010
120 MLC Corporate Global Share Fund	0.84	2/02/2010
121 MLC Growth Fund (Growth)	757.92	2/02/2010
122 MLC Growth Fund (MT)	13.56	2/02/2010
123 MLC Property Securities Fund (MT)	142.28	2/02/2010
124 MMC Small Companies Fund	53.88	30/06/2009
125 Multiplex Development and Opportunity	66.87	1/10/2008
126 Multiplex Diversified Property Fund	65.30	17/11/2008
127 Multiplex Property Income Fund	39.68	29/09/2008
128 OnePath (ING) Corporate Super Balanced Fund	415.28	10/03/2010
129 OnePath (ING) Monthly Income Trust	91.59	24/10/2008
130 OnePath (ING) Wholesale Super Australian Shares	6.47	10/03/2010
131 OnePath (ING) Wholesale Super Capital Stable	540.37	10/03/2010
132 OnePath (ING) Wholesale Super Managed Growth	10.71	10/03/2010
133 OnePath OA IP-OP Mortgage Tr No. 2	34.77	1/10/2008
134 Opes Prime	1,000.00	27/03/2008
135 Ord Minnett Global Dynamic Fund	14.10	30/08/2010
136 Palandri Agribusiness	160.00	1/02/2008
137 Perpetual Fidelity America Fund	57.18	22/05/2009
138 Perpetual Income Series Monthly Income	221.29	1/10/2008
139 Perpetual WFI-Perpetual Mortgage	8.34	1/10/2008
140 Perpetual Wholesale Monthly Income Fund	369.43	23/10/2008
141 Phoenix Technology Corporation Nexus Holdings (Walter Filler)	8.00	1/01/2000
142 Recap Enhanced Income Fund	18.84	24/12/2008
143 Rubicon Holdings Australia	245.38	1/10/2008
144 Schroder Geared Global Active Value Fund (Hedged)	128.56	31/07/2009
145 Select Gottex Enhanced Market Neutral Fund	27.79	13/11/2008
146 Select Gottex Market Neutral Fund	61.30	13/11/2008
147 SG Hiscock Hybrid Property	15.52	1/10/2008

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148 SSgA Aust Listed Property Index Trust	7.90	30/04/2009
149 SSgA Global Fixed Income Trust	1.10	30/04/2009
150 Storm Financial	3,000.00	15/01/2009
151 Tankstream Property Investment Fund	9.52	27/08/2008
152 Timbercorp Agribusiness	200.00	23/04/2009
153 Trilogy (City Pacific) First Mortgage Fund	520.00	1/10/2008
154 Trilogy Healthcare REIT	6.70	30/06/2012
155 UBS Australian Equity Income Fund	4.67	25/05/2010
156 UBS Credit Enhanced Cash Fund	18.47	19/03/2009
157 UBS Global Infrastructure Fund	0.18	2/03/2009
158 UBS Protected Cash Fund	0.53	14/04/2010
159 United Funds Management Australian Shares PST	5.26	16/11/2009
160 United Funds Management Capital Growth PST	8.14	16/11/2009
161 United Funds Management International Shares PST	30.23	16/11/2009
162 Wellington Premium Income Fund	755.88	29/01/2008
163 Westpoint Group	388.00	15/01/2006
164 Wickham Securities	27.00	1/03/2013
	37,301.30	