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HD **Kept in the dark?**

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Thousands of people saw their life savings wiped out when the "low-risk" fund into which they had put their nest eggs imploded last year. Benjamin Robertson looks into the murky world of LM Investment Management and what its collapse should signal to the investing public.

very day at dawn, Justine Clark saddles up her charges at the Sha Tin racecourse and takes them out for a morning gallop. Looking after thoroughbreds can be a dangerous business; her husband, Steven, works alongside her and once broke his leg putting the horses through their paces.

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The 40-year-old mother-of-two had hoped to have her own home back in Australia by now, and be financially secure. Those plans ended abruptly last year, when the family's life savings disappeared in a scandal that decimated the finances of thousands of expatriates across Asia.

"I didn't want [a high-risk investment] as I didn't want to lose the money we had saved," says Clark, sitting in an **apartment** provided by her employer, the **Hong Kong** Jockey Club, near Fo Tan MTR station. "It was meant to be low risk. It was **sold** like a term deposit in a bank."

In 2007, while working at a stud farm in Hokkaido, northern Japan, the Clarks put their entire savings – 17 **million** yen (HK$1.1 **million**) – into an Australian investment fund called LM First Mortgage Income Fund, after seeking advice from expatriate financial advisory **firm** Global Wealth Management (GWM). The fund invested in Australian mortgages.

Two years later, during the global financial crisis, the fund was suspended, meaning investors could not take any of their money out. The Clarks would have to wait patiently to reclaim their nest egg, they were led to believe.

In March last year, though, disaster struck. The fund's Brisbane-based management **firm**, LM Investment Management, collapsed, blindsiding 12,000 investors worldwide and triggering an investigation by the Australian Securities and Investments Commission. LM had A$3 **billion** (HK$21.7 **billion**) in assets, according to **company** literature.

Clark is now trying hard to save money for her family's future.

For others, the fallout from LM's failure has had an even more dramatic impact.

"It has been devastating for me and my family and, to a large degree, the cause of a pending divorce," says Steve Collins, who made a series of investments totalling US$1.2 **million** in another LM fund, the LM Managed Performance Fund (now valued at five cents on the Australian dollar), between 2006 and 2010. The 58-year-old had built a successful software **company**, which he **sold** before moving from **Hong Kong** back to his native South Africa. He calculates he may lose more than half his life savings through the LM debacle.

ADMINISTRATORS SAY THEY do not yet know why LM failed, but many advisers now report there were signs of trouble as far back as 2009.

For many, LM's crash has raised urgent questions about a dangerous complacency and dubious commission system in the financial advisory sector, which have caused investors across the continent to worry if their nest eggs are at risk, too.

Many investors in LM, who face losing a large percentage of their life savings, complain that they were kept in the dark by their advisers about problems in the Managed Performance Fund and at the **company** itself.

As far back as 2009, four years before the fund's descent into administration, LM started delaying payouts to existing investors who wanted to exit the Managed Performance Fund. But new investors said they were never told of this before they wired across their money.

LM funds were **sold** to expatriates living across Asia, the Middle East and parts of Europe. The **company**'s demise has left those investors wondering who to rely on for professional investment advice, especially when living in countries where local regulators appear indifferent to the plight of foreign residents.

"I have not a clue [who to complain to] and I don't trust anyone here," says Thailand-based British expatriate Charles Baker.

In preparation for his retirement, he invested a large amount of his savings in the LM Managed Performance Fund.

Launched in 2001, this fund, one of more than half a dozen operated by LM Investment Management, lent money to Australian **property** developers and paid out fixed returns slightly above prevailing interest rates, making it popular with clients nearing retirement.

"They said they had a very good fund going at that time, a guaranteed fund; [as] good as putting the money in the bank," says Baker, describing how LM funds were pitched to him by Thailand-based expat advisory **firm** Barclay Spencer International.

LM's collapse has left the 67-year-old worried for his wife and child, as the money he lost was earmarked for living expenses and his daughter's education.

In Australia, lawsuits are being prepared against locally based advisory firms on the basis that the LM funds "were inherently high-risk products and conservative investors should never have been advised to invest in [them]", says Anastasia Salamastrakis, media adviser at the Melbourne office of law **firm** Slater & Gordon.

But that is unlikely to help Asian investors.

WHAT IS PARTICULARLY ALARMING is the speed at which LM Investment Management zipped from being flush to flat broke. Between 2009 and 2013, the Managed Performance Fund, the **firm**'s flagship product, had more than quadrupled in size, from A$95 **million** to A$397 **million**, according to forensic accountancy **firm** KordaMentha, the court-appointed administrator of the fund.

KordaMentha says it is still trying to recover as much of the investors' money as possible and has started legal proceedings against Peter Drake, the founder and chief executive of LM Investment Management, in Queensland's supreme court.

"The Managed Performance Fund hadn't lost a cent of earning or unit price in 12 years," says Drake, claiming it was one of the best performers in its class.

Asked where the fund's money has gone, Drake blames costly margin calls on currency hedges used by the fund to protect foreign investors against the lost value of the Australian dollar. He also slams the administrators for selling fund assets at fire-**sale** prices, thus diminishing its value.

A rival fund owner has a different theory, however.

"When you did the arithmetic … the cash [coming in] was being used just to pay two things – fees and income distribution – and that is the classic Ponzi scheme," says Rodger Bacon, chairman of Australian fund **group** Trilogy. After becoming suspicious, Bacon hired a barrister to investigate LM in 2012, a year before its collapse. Using a procedure permitted under Australia's securities law, Bacon then persuaded clients in another LM fund to elect Trilogy as the fund manager to replace LM.

Drake denies that Bacon's theory is true.

"That's ridiculous," says Drake. "A Ponzi, as I understand it, is where there is no asset."

Bacon’s accusation is a serious one: a Ponzi is a fraudulent scheme whereby existing investors receive any promised dividends and payouts from the funds put in by new investors, rather than from income generated by the scheme’s assets.

Last year, the court froze Drake’s assets and seized his passport. In September his beachside home on Australia’s **Gold** Coast was **sold** by administrators for A$7.35 **million**.

According to several advisers in **Hong Kong** and Japan, generous commissions paid by LM encouraged financial advisers to push the Managed Performance Fund to ordinary investors ahead of others on the market.

While many funds don’t pay them commission, financial advisers are often not required to tell clients how much, if anything, they earn when recommending a particular fund. This makes it difficult for clients to know whether they are getting impartial advice.

LM’s commission rate for the Managed Performance Fund was 3 per cent of the invested total up front, plus another 3 per cent for every year a client’s money remained in the fund, say advisers and Drake.

The fund offered fixed-return, term-deposit products designed for short-term investment. But it was beneficial to advisers to keep their clients’ money in the fund for as long as possible, as they would continue to receive annual commissions.

In the fund’s final year, the upfront commission rate jumped to 9 per cent, several advisers say. Drake disputes that, saying the 9 per cent rate was always available if a client committed to a three-year investment term and the adviser waived the 3 per cent recurring annual commission. In short, the longer a client locked up their money, the more commission the adviser got.

Nevertheless, some financial advisers got spooked.

“They were changing their remuneration model, their fee model,” says the chief executive of one **Hong Kong** advisory **firm**, who says he stopped selling LM funds in 2009. “They were changing their lock-up model and liquidity model.

“It seemed to us that they were just trying to squeeze a bit too much out of what they had, to make it more attractive,” adds the executive, who asked to remain anonymous.

Martyn Terpilowski, then a financial adviser in Tokyo, says he also became suspicious in 2009. At that time, he had three clients who had invested a total of US$2.5 **million** in the Managed Performance Fund.

In an e-mail, seen by Post Magazine, to an LM sales executive in December of that year, Terpilowski wrote, “I cannot pretend that I am still happy with what is going on at LM. The fact the fund continues to campaign for new funds at the same time that redemptions are suspended sets it apart.” Terpilowski was referring to standard industry practice, which is to suspend a fund by not accepting new money in, or paying money out, until the fund manager has resolved any problems.

Despite sending several redemption requests (an investor’s application to get their money back), Terpilowski says his clients recovered less than 5 per cent of their money before the fund failed.

“The growth was fuelled by the greed of advisers,” says Terpilowski, describing the Managed Performance Fund as a scam. “I don’t believe that clients were aware when investing new money of the new commission levels or the redemption problems, or why would they invest?”

Drake denies the fund was fraudulent. He says financial advisers knew about the cash-flow problems from 2009 onwards, adding that “hundreds and hundreds” of independent advisers invested client money each month because there weren’t many profitable options during the recession that would have enabled them to “make a living”.

Magellan Tresidder Tuohy, a financial advisory **firm** based in Tokyo, had more than 200 investors with a combined A$30 **million** locked up in various LM funds, says Simon Litster, a Magellan director who personally invested in LM’s products.

He says his **firm** knew about problems with the Managed Performance Fund in 2009, as the wait time for clients to get redemptions rose from three months to 18 months. Magellan continued to sell the fund into 2012 because LM provided reassurances, Litster says, including audited reports.

Drake says all advisers knew of the redemption problems. “Every business meeting we had and every document disclosed that,” he says. “And it was like, ‘Guys, at the moment we are behind on redemptions but the choice is we either keep running the fund and grow through this or we close it up.' And … the IFAs [independent financial advisers] accepted that."

The timing is important. In Baker's case he invested £110,000 into the Managed Performance Fund in 2008 for one year. He then extended the one-year term in 2009 and again in 2010. In July 2011, he committed to locking his now £137,168.65 into a three-year term, which paid 9 per cent interest per annum.

Baker's adviser at Barclay Spencer, Andrew Wood, says he became aware of fund redemption delays in 2010 and started telling clients in 2011. Baker says Wood did tell him about the delay when they met in person, but he can't recall the exact date. He strongly believes it was after he made the three-year investment.

"I find it unlikely I would have put my money into something where I would not get it back," says Baker.

Wood declined to comment on whether he remembered the date of the meeting and on whether he pitched the fund as low risk. He did say his **company** had visited LM's Australia offices and conducted a number of due diligence checks. These included a review of LM's accounts and registration details. In the future, Wood says "stricter standard due diligence tests" should be applied to investments by advisers and regulators.

In 2009, Wood's **firm** was acquired by **Hong Kong**-based Platinum Financial Services.

A spokeswoman for Thailand's Securities and Exchange Commission (SEC) says it can find no record of a licence being granted to his **firm**, under either of its names, or to Wood himself. The spokeswoman says it is an offence to give investment advice without a licence in Thailand. Wood was asked by Post Magazine to provide proof that he and his **firm** are licensed. He did not do so.

Under Thai law, a **company** not being licensed properly does not automatically invalidate any fund **sale**, says Chatchavej Chitvarakorn, partner at Bangkok-based Siam Premier International Law Office.

The penalty for doing business without a licence is between two and five years' imprisonment and a fine of 200,000 baht (HK$48,650) to 500,000 baht. However, Chatchavej says, the SEC lacks the resources to monitor all the funds and companies in the market.

INVESTORS INTERVIEWED BY Post Magazine say they pledged fresh money or rolled over existing commitments to the Managed Performance Fund in 2009 or later, unaware there were any redemption problems.

"We were told [the funds] were as safe as a bank account. In hindsight, why wasn't I advised to diversify? We were clueless about investments and completely reliant on our advisers," says Stephen Yap, who invested a HK$5 **million** inheritance into the LM First Mortgage Income Fund in 2008, using Financial Partners **Hong Kong**, one of the biggest sellers of LM funds in the SAR.

Financial Partners senior executives Peter Kende and Howard Clark-Burton have defended the **sale** of LM funds and say, in an e-mail, that the **firm** is now trying to help clients retrieve their money.

"Once we became aware of issues at the Managed Performance Fund, Financial Partners ceased all new offerings, and programmed all existing clients to redeem their holdings at their next maturity date," write Kende and Clark-Burton.

Clients interviewed dispute this, saying they only found out the fund was in difficulty after LM went into administration.

Another Financial Partners client, who expects to lose HK$2 **million** in the Managed Performance Fund, called LM's collapse a "disaster" for her family. She requests anonymity and is suffering from depression. Collins, the software entrepreneur who may lose half his savings, also used Financial Partners.

Stephanie Mathyssek and her husband invested A$50,000 in the Managed Performance Fund in May 2012, just 10 months before it collapsed. They also used Financial Partners. She now wishes she had done more research on the fund before investing. "[Financial Partners] flog it as low risk but it was anything but low risk," she says.

In May, Financial Partners commissioned Gary Halsall, of Compliance Solutions (HK), to do an investigation into the advisory **company**'s selling of the LM fund to Mathyssek.

The investigation was pitched as being "independent", says Mathyssek, and the final report cleared Financial Partners of any blame in recommending LM funds. Mathyssek was unhappy with the report.

She felt it did not adequately scrutinise the due diligence analysis conducted by Financial Partners on LM. A copy of the report was passed to Post Magazine.

What Financial Partners did not tell Mathyssek was that Halsall was a former employee and had in fact **sold** the Managed Performance Fund to an earlier client. His name and signature appear on client documents sent to Post Magazine by another aggrieved investor.

Clark-Burton defends the report, saying Halsall was “professional” and “independent”, and there was “no conflict of interest”.

“Gary does understand the fund, having done his own due diligence on it in the past, so he fully understands that side of things. He can bring a different level of understanding,” says Clark-Burton.

Halsall declined to comment citing client confidentiality.

MOST INVESTORS IN THE Managed Performance Fund were never told about the redemption problems, says Graham Smith, founder of the LM Investor Victim Centre, which helps represent LM investors in **Hong Kong** and overseas. In many cases, the advisers disappeared the moment LM failed, he says.

Smith is trying to spearhead a global response by encouraging his 525 members to write to Australia’s prime minister and their local politicians.

As many as 10 advisory firms **sold** LM funds in **Hong Kong**, according to advisers and the LM Investor Victim Centre. While Australian authorities regulated LM, none of the **firm**’s funds were licensed by the Securities and Futures Commission (SFC) for **sale** in **Hong Kong**.

Although many unlicensed investment funds are **sold** in **Hong Kong**, under local regulatory rules, an investor buying a fund in their own name – a so-called direct fund **purchase** – should sign a professional investor declaration form and prove liquid assets of HK$8 **million** or more.

Several clients of Financial Partners say they didn’t or weren’t required to show that proof. On their application forms, the sections regarding professional investor status have been crossed out.

When asked about the paperwork, Kende and Clark-Burton say they cannot comment on specific client arrangements, and the SFC has declined to comment.

Some advisers say it is unfair to single them out.

“Should we have known that a **company** in one of the [most strictly regulated countries] in the world didn’t know what they were doing? How should we have known [there was something wrong],” asks Sean Kelleher, chief executive of Mondial, a Middle East-based wealth advisory **firm**.

He says his **firm** first did due diligence on LM in the early 2000s, when the Managed Performance Fund started. Kelleher became suspicious in mid-2012, when several LM directors resigned, but he did not stop selling the **firm**’s funds until later in the year, six months before LM went into administration. He calls LM’s collapse a “potential turning point” for the advisory industry in how it conducts due diligence on funds.

“We work off platforms [life-insurance companies] that say their job is to provide us with prices and do the due diligence on the accuracy of prices and, in that environment, we deal with hundreds of funds,” Kelleher says.

A review of the Managed Performance Fund’s audited accounts reveals the loans and prepayment of management fees that are now the subject of investigation. These accounts were available to any advisory **firm**.

While common practice is for fund managers to diversify their holdings, the accounts show that a hefty 60 per cent of the Managed Performance Fund was tied up in one asset, a HK$1.4 **billion** mortgage on Maddison **Estate**. This was a Queensland-based **site** where Drake planned to build a **residential** compound. LM promoted Maddison **Estate** as having a future value of HK$6.8 **billion**. KordaMentha valued the still undeveloped **site** at HK$145 **million** to HK$163 **million**. According to KordaMentha, loans made by the fund to real-**estate** projects are still under investigation.

Underpinning wider confusion in the industry as to who should take responsibility, several life insurance firms have told Post Magazine that it is up to advisers and clients to do due diligence and assess a fund’s suitability. However, insurance companies can block a fund from trading on their platform.

It was in this context that, in late 2011, Terpilowski started sending e-mails to **Hong Kong**-based executives at Royal Skandia and Friends Provident, to alert them to his concerns about the Managed Performance Fund. In one e-mail reply, seen by Post Magazine, a Friends Provident executive writes, “You can imagine that IFAs don’t give me much negative feedback about this fund, so thanks very much for sending this.”

He is saying advisers do not complain about a fund that pays high commissions, explains Terpilowski.

Friends Provident says the **firm** investigated the complaint and that “at the time of [Terpilowski’s] e-mail, Friends Provident International’s own customers seeking to redeem their investments in the fund were receiving their redemption monies,” the **firm** wrote in a statement.

Royal Skandia also says it looked into the complaint.

“I can confirm that redemptions were only suspended for a short period of time and resumed very quickly. At that time there was no further cause for concern,” writes Mark Christal, Royal Skandia’s **Hong Kong** general manager.

Both firms continued to allow clients to trade LM funds.

However, Drake says redemption delays affected all the Managed Performance Fund’s clients, and that his colleagues talked to the insurance companies for “hours at night explaining how the fund worked and what a delay is”.

While clients investing their life savings might expect an advisory **firm** to conduct due diligence on the funds they are selling, this assumes small advisory firms have the manpower to properly screen hundreds of funds.

“The research done on investment products is quite narrow. Due diligence usually doesn’t investigate the investment’s robustness, the operating systems [**transactions**, custodial, reporting, etc], the technology, the service agreements [if arrangements are outsourced] and a whole host of other factors,” says Michael Roberts, director at Australian wealth management **group** Bailey Roberts.

Roberts says he did not sell LM funds. Since 2006, Australian investors have lost A$40 **billion** in more than 160 failed investment schemes and managed funds, he says, adding, “This is a huge indictment of our industry.”

PETER NESS, A FORMER ADVISER at the **firm** used by the Clarks in Japan, says GWM invested with LM for many years. He admits, though, that the **firm** “did not have the people with the skills and expertise” to study funds and only a handful of people working there had a university degree.

Instead, GWM took comfort from seeing major banks and insurance companies doing business with LM.

Ness advised the Clarks on their LM investment. He says he did recommend that the Clarks diversify their investment portfolio but his advice was rejected. The Clarks say they chose LM because Steven is Australian and they planned to move there.

Ness left the industry in 2010. He calls on regulators and governments to better police the sector and says both the advisory firms and life insurance companies are to blame for shoddy practices in the industry. (E-mails to GWM’s Tokyo office went unanswered and the phone number on GWM’s website connects to an unrelated **firm**.)

For the Clarks, and many other investors, such warnings come too late. They are now left wondering whether they will ever get any of their savings back.

“If we had put it in high risk or even medium risk [funds] we would have held our hands up and said we took the gamble and this is what happened – but that was not the case,” says Justine Clark.

“Our plans have gone out the window.”

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