

UPDATE ON FINANCIAL SERVICES CLAIMS IN IRELAND 2011

Introduction

With the downturn in the economy, particularly the property market and volatility in the stock markets, claims against financial institutions, financial advisors and promoters of financial products have increased significantly. Many investors have found the value of the capital invested in financial products has been reduced or wiped out entirely. As a result, financial institutions, promoters of financial products and financial advisors have been subject to a greater level of scrutiny than ever before. In addition to their various statutory and any contractual duties they owe a duty of care in tort to their clients. Accordingly, they may be held liable for any negligent advice, negligent misrepresentation and/or mis-statement which causes their clients to suffer a loss

Statutory Instrument No. 60/2007 — European Communities (Markets in Financial Instruments) Regulations 2007 (MIFID) was signed into law in November 2007 soon after the recession commenced providing additional grounds for claims. These regulations effectively place many of the duties that exist at common law on a statutory footing together with additional duties. Regulation 76, for example, requires investment firms to “*act honestly, fairly and professionally in accordance with the best interests of its clients*”. The phrasing is significant in that the common law requires “professionals” to exercise a standard of care commensurate with other reasonably prudent professionals of their background and experience. The regulations also contain a specific requirement to ensure “*all information addressed by an investment firm to clients or potential clients are fair, clear and not misleading*” and to alert clients to the risks associated with particular investments so that they can make informed decisions.

Claimants can seek redress through the Financial Services Ombudsman (FSO) or the Courts. The FSO deals with complaints concerning a variety of financial service providers such as Insurance Companies, Banks, Credit Unions and investment intermediaries. This is suitable for smaller claims of up to €250,000 and there is no risk of having to pay the other side’s costs if the matter is successfully defended.

Claims, trends and cases

The bulk of recent civil claims arise from the following:-

- 1) Mis-selling of financial products to investors;
- 2) Failure to explain the terms of the product to investors properly;
- 3) Misleading and/or false representations made to investors;
- 4) Failure to maintain proper up to date investment mandates and to invest the money specifically as mandated by the client;
- 5) The selection of investments inappropriate to risk appetites.
- 6) Conflicts arising from acting as promoter of particular product and investment manager at same time;
- 7) The downturn has also brought to light a lot of fraudulent activity which might not otherwise have been spotted. This includes misappropriation of client monies and alleged ponzi schemes.

There were 2,584 complaints to the FSO against banks in 2010, more than any other service provider. Figures are not available for the number of claims against financial institutions taken in the Courts, though several cases have been reported in the newspapers.

Mis-selling of financial products accounted for over 37% of investment complaints to the Financial Services Ombudsman during the period 2007-2010. Investments must be what they are represented to be and be suitable for the investor’s profile. Financial advisors must obtain appropriate “know your client” information such as the client’s age, dependents, available income, assets and existing

investments/potential liabilities, investment experience, investment objectives and attitude to risk/desired level of risk for the investment, among other things before recommending a financial product.

One of the most publicised cases involving mis-selling in recent years was *Kilmartin v Bank of Ireland*. This was a Circuit Court Case. The Plaintiffs were two pensioners in their seventies. They were advised by Bank of Ireland to take out a 15 year endowment mortgage rather than traditional annuity mortgage. It was held that the documentation failed to highlight the risks associated with the product. The judge held the Kilmartins were entitled to recover the shortfall of the endowment policy to meet the €63,000 mortgage on maturity and measured that sum at €6,039. They were also entitled to €1,963 compensation for additional premiums and interest as well as €8,000 for loss of projected surplus, making a total award of €16,002.

Several cases have been taken in the High Court involving bonds. In the case of *Solicitors Mutual Defence Fund (SMDF) v Bloxham Stockbrokers*, for example, the SMDF sued Bloxham over €8.4 million (over 30% of its investment portfolio) invested in a bond that lost over 97% of its value. It was alleged that Bloxham failed to properly explain the nature of the bond and to properly advise the SMDF of the risks associated with this particular type of investment. Bloxham in turn claimed that Morgan Stanley failed to advise them of early redemption possibilities. A number of other sets of proceedings were brought by various parties over the same bond.

In separate proceedings over 400 investors are said to be suing ACC in connection with their purchase of bonds. These were leveraged tracker bonds. While capital was guaranteed, most of the investors borrowed funds to buy the bonds. Losses arising from interest repayments on the loans are being claimed and these cases are ongoing.

Similar complaints have been made to the Financial Services Ombudsman against financial institutions. The FSO recently ordered a bank to refund in full €410,000 invested in Property Bond. A customer of a bank, aged 68, had sold her family home in 2007 and lodged her portion of the sale proceeds with the bank in December 2007. She had separated from her husband, had no pension was working part time but had little prospect of obtaining a full time job. She met with the bank in 2008 to discuss investment opportunities. She already had €100,000 invested in one of the bank's property fund bonds. She was advised to invest the rest of her money in the same fund and claimed that no alternative investment strategies were discussed. By October 2008 the €410,000 investment had fallen by €224,000 to €186,000. There would also be a penalty of €10,000 if it was cashed in at that date. The FSO directed restitution. The Complainant was directed to return the bond to the bank and the Bank was to return her original investment of €410,000 to her simultaneously. This effectively restored both parties to the position they would have been in prior to the investment being made and prior to the banks alleged breach of duty. On the face of it, the investment was unsuitable for the complainant given her investor profile, her age, means and existing investment exposure to property.

There have also been some significant and well publicised cases against financial institutions arising from the loss of title documents. A recent example of this was in *A.C.C. Bank PLC v Fairlee Properties Limited Jerry Beades and Niall Ring*. ACC Bank were pursuing Jerry Beades, a developer, for monies advanced to him. He counterclaimed against the bank for losing his title deeds to properties in Dublin. ACC were unable to produce those deeds in June 2004 when requested to do so. The Court found that if ACC Bank had produced the title documents in June 2004 that Mr. Beades would have obtained full development finance from another lending institution and commenced construction by March 2005. Construction would have taken approximately twenty-two months and therefore he would have completed and been able to effect sales of the apartments from January 2007. It was held that the loss of title deeds caused delay in the development and a consequent reduction in the profits achievable on the development. Mr. Beades was awarded €4.4 million for probable reduction in profits.

Regulation

The Central Bank of Ireland/Financial Regulator is responsible for regulatory enforcement. While Claimants may not obtain compensation through the Financial Regulator, complaints can be referred to it by the Financial Services Ombudsman for investigation where breaches of the applicable regulations appear to have occurred. The Central Bank can also commence investigations without such a referral.

An investigation by the Central Bank can have very serious consequences. The financial service provider concerned could ultimately lose its authorisation to trade in a regulated market or to provide particular investment services. It could even be placed into liquidation as occurred *In the Matter of Customs House Capital Limited* on 21 October 2011. The firm was the subject of a Central Bank inspection in March 2009 after concerns were raised that they were using investors' money to cover shortfalls on European property deals without client's knowledge or consent. Upwards of €56 million is alleged to have been misused in this way. Inspectors were appointed by the High Court in early 2011 on the recommendation of the Central Bank, to investigate the affairs of the company. The inspectors report was presented to the High Court on 21 October 2011. It concluded among other things that there was a systematic and deliberate misuse of assets and cash belonging directly or indirectly to clients of Customs House Capital Limited.

Judge Gerard Hogan referred to the company as "a sort of Irish Ponzi scheme" and referred the report to An Garda Siochana, the Minister for Justice, the Director of Public Prosecutions, the Revenue Commissioners and the Director of Corporate Enforcement. Whether any of the directors will face criminal charges remains to be seen. The track record of the authorities in prosecuting white collar crime in Ireland to date has been extremely poor.

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