

Appointment of Inspectors to Custom House Capital Limited - Questions and Answers

1. Why has the Central Bank sought the appointment of Inspectors to Custom House Capital Limited?

The Central Bank has taken this action in order to evaluate the records of the firm relating to client assets and customer holdings and to assess the financial position of the firm. The Central Bank has significant concerns about the status of client assets managed by Custom House Capital.

The Central Bank is taking this action to protect clients. The action is necessary in the interests of the proper and orderly regulation and supervision of investment firms, and for the protection of investors.

2. What issues have arisen in Custom House Capital?

The Central Bank has had an increased level of engagement with the firm since 2009, when the Central Bank first received information which gave rise to concerns on its part regarding the Firm's compliance with specific regulatory requirements.

However, in July 2011 the Central Bank received new information which heightened the Central Bank's concerns for the firm's clients. The Central Bank now has significant concerns about the status of certain client assets managed by Custom House Capital.

In this context, we have considered what steps are necessary and appropriate to protect clients of the firm and have formed the view that in addition to the recently imposed directions an Inspector was required to be appointed to investigate the new information that has been received.

3. Why have you prevented clients of Custom House Capital from accessing their funds?

The Central Bank has placed restrictions on the firm preventing it from carrying out any transactions or making payments to any clients in order to protect the interests of all existing clients until the impact of these issues have been fully established.

It is necessary to definitively establish the individual account information for all clients through a detailed assessment process over the coming months.

4. Can clients get access to their funds now?

No, because directions have been imposed by the Central Bank placing restrictions on the firm which prevent it from carrying out any transactions or making any payments to clients until the true situation of all client holdings is established.

The directions were imposed on foot of new information received in July and subsequent developments and seek to prevent the dissipation of client assets and monies by placing a freeze on redemptions by the firm and the sale and purchase of investments by the firm on behalf of its clients.

5. How long are the directions in place for?

We expect the directions will remain in place until the Inspectors investigation is complete, a report made and a decision has been taken on how best to resolve the situation in the interest of investors.

6. When will you report back to the Court with the Inspectors findings? How long will the Inspection take?

Following the presentation to the High Court of the second interim report of the Inspectors on Friday 29 July, the Court directed that the appointment of the Inspectors continue. The matter has been listed again in Court for Tuesday 6 September 2011 and further information will be provided to the High Court on that date.

7. When did concerns about the firm first arise?

The Central Bank has given increased attention to the firm since early 2009, when the Central Bank first received information which gave rise to concerns on the firm's compliance with specific regulatory requirements.

8. What action has been taken since 2009?

The Central Bank has taken a number of actions against the firm to date. The Central Bank conducted inspection of the firms' books and records and has issued additional requirements and directions in relation to the management structure of the firm. Directions were also issued on the management of client assets and returns to be made to the Central Bank relating to these assets.

Where the Central Bank was not satisfied that clients were fully aware of the nature and risks attached to a certain investment product they were invested in, it required the firm to contact these clients to offer them the return of their investment or remain invested.

In cases where the Central Bank had concerns regarding the lack of documentation on client files, the firm was requested to write to those clients offering the return of their investment.

In the absence of an ability to formally appoint administrators to Custom House Capital Limited and being mindful that a liquidation event would impose enforced losses on investors, throughout the process the Central Bank's approach has concentrated on the possibility of Custom House Capital Limited transferring clients to an alternative investment manager.

9. What directions have been imposed on the firm?

Details of directions issued are detailed in the Affidavit.

A number of directions and requirements were imposed on the firm during 2009 and 2010 curtailing the activities of the firm.

The directions and requirements issued in 2009 were:

- The firm was instructed to recruit an independent non-executive director and two new senior staff members, including a new Compliance Officer;
- The firm was required to clarify the financial position of each syndicated Special Purpose Vehicle, used for holding an individual property, with particular reference to identifying current valuations compared with valuations at time of purchase along with any shortfalls in equity being raised;
- Directions were imposed to ensure that no further monies were put into the Mezzanine Bond Fund and that when bridging finance was no longer required in property transactions these monies would be returned to clients;
- A direction that the firm must seek prior written approval of the Central Bank in respect of any proposed new investment product; and

- An increase in the regulatory capital requirement (for capital adequacy purposes) to €5,000,000 in order to cover potential liabilities arising for the firm on the Mezzanine bond.

Further directions issued in April 2010 were:

- Segregate any returns to the Mezzanine Bond in a separate client account and not to make any payment out of this account;
- Prevent any further investments in property special purpose vehicles without the prior consent of the Central Bank;
- Segregate the money raised by the firm through subordinated debt;
- Not to pay any dividends to shareholders or provide any loan to a director;
- Cease to take on new clients or to engage in new investments on behalf of existing clients unless the firm is obliged, under its agreements with such clients, to process such transactions; and
- Not to advertise or solicit to new or existing clients in respect of the supply of investment or ancillary services.

10. What actions were taken to assess the security of client assets?

Central Bank rules require that an investment firm receives an independent audit of the security of client money assets on a regular basis. Custom House Capital's previous auditor, which was changed in 2009, did not identify any mis-use of client assets in the reports it prepared.

In early 2009 Central Bank policy was changed to require audits of client assets every 6 months from all relevant investment firms due to concerns the pressure of the financial crisis may lead to the integrity of funds being compromised¹.

From 2009 the Central Bank has received 4 reports on Custom House Capital's client assets from the new auditors. No evidence was found at that time of the misuse of client assets.

Client Asset inspections were conducted by the Central Bank in 2007 and 2009 and while issues were identified, no evidence was found of the misuse of client funds.

As part of the process of transferring client holdings to an alternative investment manager in July 2011, new information was presented to the Central Bank raising significant concerns regarding client assets.

11. Are clients of Custom House Capital likely to lose money because of this?

While it is too early to say in advance of the Inspectors' report, there is a possibility that some clients may lose money. A number of investments managed by Custom House Capital on behalf of clients are property related investments.

Directions have been imposed by the Central Bank placing restrictions on the firm preventing it from carrying out any transactions or making any payments to/for clients until the true situation of all client holdings is established. Any actions taken by the Central Bank are taken in the best interests of customers.

¹ In addition to this action the Central Bank wrote to the auditor representative body in 2010 outlining its concerns around the conduct of client asset audits and highlighting the need for greater diligence of auditors in the conduct of client asset audits.

12. How much is involved?

We are not in a position to disclose this information in advance of the Inspectors report.

13. What regulated activities does Custom House Capital conduct?

Regulated activities conducted by Custom House Capital include the provision of asset, portfolio and investment management services as well as pension advisory services as an approved Qualifying Fund Manager to Approved Retirement Funds (ARFs) and similar products. It has approval from the Pensions Board to operate a number of non-standard PRSAs. A significant portion of the assets managed on behalf of clients are related to property investments.

The firm also conducts a number of activities that are not subject to regulation. The firm also operates a significant amount of unregulated investment vehicles such as Exempt Unit Trusts and these assets managed within these trusts relate to property, equities and cash holdings.

14. What is the impact on products regulated by other bodies?

The Pensions Board and the Revenue Commissioners are jointly responsible for approving PRSA products. The Pensions Board and the Revenue Commissioners have approved three non-Standard PRSA products operated by Custom House Capital. The Pensions Board regulates PRSA Providers in the context of their products as outlined in Part X of the Pensions Act and relevant Regulations.

Following the restriction placed by the Central Bank on Custom House Capital preventing it from carrying out any transactions or making payments to any of its clients, the Pensions Board, in accordance with Section 97(1)(e) of the Pensions Act, suspended the approval of the 3 CHC non-Standard PRSA products with effect from 15 July 2011.

This suspension prevents Custom House Capital from accepting new contributors or further contributions in respect of the said 3 PRSA products during the period of suspension. In accordance with Section 97(4) of the Pensions Act, Custom House Capital was required to immediately inform, in writing, any contributor who may be affected by the suspension of the 3 non-Standard PRSA products.

15. Will investors be entitled to any compensation?

Investments that are covered by the Investor Compensation Scheme may be eligible for compensation up to 90% of the amount lost, subject to a maximum of €20,000. Further details on the Investor Compensation Scheme are available at <http://www.investorcompensation.ie/index.php>

If you are a client of Custom House Capital and have further questions please email the Central Bank at enquiries@centralbank.ie and we will endeavour to answer your questions.